ECONOMIC ADJUSTMENT
PROGRAMS

Argentina

CONFIDENTIAL

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ARGENTINA: BAKER INITIATIVE COUNTRY STUDY

I. Initial Conditions

Economic Performance

1. Argentina's economy has been adversely affected by a poor political milieu and inappropriate economic management since the early 1950s. Over the last decade, abrupt shifts and inconsistencies in policies weakened Argentina's productive capacity and exacerbated structural imbalances. Economic mismanagement led to an increase of the country's external debt, which, as a share of GDP, has multiplied almost seven-fold (from 10% to 67%) during the last decade. Interest payments on the external debt now absorb about 40% of gross domestic savings compared to less than 5% in the early 1970s. While the external debt increased, domestic production declined. In 1985, real GDP per capita was 13% below its 1974 level. Investment declined to 13% of GDP, from an average of 21% during the early seventies.

2. The productive sectors, particularly manufacturing, are beset by thorny structural and financial problems. More than 40% of capacity in the construction industry now stands idle. Significant underutilization of capacity also exists in many manufacturing industries; and most firms also lack sufficient working capital. Financial intermediation is costly and inefficient, interest rates are high in real terms, and oversized banking institutions are suffering severe difficulties. Argentina's self-sufficiency in oil has deteriorated as the ratio of oil reserves to annual output has declined. Proven reserves of gas have increased, but the processing and transport infrastructure to exploit them is deficient.

3. Unfavorable changes in the external environment during 1979-82 further aggravated domestic problems. Argentina suffered external shocks equivalent to 4% of GNP owing primarily to deteriorating terms of trade and high interest rates. This situation was compounded by a deterioration in export competitiveness and a rapid increase in imports as the peso became increasingly overvalued. The policy response was primarily to resort to additional external borrowings. This was accompanied by some contraction of economic activity. The unfavorable external shocks and the poor policy response were further compounded by the South Atlantic war and subsequent political instability.

Stabilization Efforts

4. A democratic Government took office in 1983. The Alfonsin administration confronted a difficult situation: the economy was in poor shape following the 1982 military adventure, inflation was running at close to 20% per month, the fiscal deficit was about 16% of GDP, and the external debt exceeded US$45 billion. Nevertheless, most social groups greeted the new Government with strong expectations for an improvement in their living standards. The Government first used a gradualist approach to tackle Argentina's problems, but with little success. There was a modest gain in real output led by real wage increases but, in order to finance a seemingly

chronic public sector deficit, the Government was obliged to resort to domestic financing, which produced a steady increase in inflation. The Government entered into a stand-by agreement with the Fund but was unable to meet the agreed targets. As the economy came perilously close to complete chaos, the Government changed gears and moved to shock treatment in mid-June 1985 with the Plan Austral and then reached agreement with the Fund on revised targets.

5. The Plan's main features were: (a) introduction of a temporary wage-price freeze to be supervised through spot-checks. However, before that a number of critical prices were adjusted. These included various public sector prices and an 18% devaluation; (b) a drastic cut in the overall public sector cash deficit, with the purpose of reducing it from 12.5% of GDP in the first half of 1985 to 2.5% in the second half of 1985. This was to be accomplished by increasing tax revenues, reducing real wages, and from falling interest payments resulting from lower inflation. The Government committed itself not to resort to Central Bank credit and to finance the deficit through capital inflows; and (c) a monetary reform introduced a new currency, the Austral, pegged to the U.S. dollar at a fixed rate.

6. The initial results have been impressive: monthly inflation has fallen from about 30% in May to 6% in June and about 2% per month on average during July-November; the overall public sector cash deficit has been cut down to slightly above 3% of GDP in the second half of 1985 without Government recourse to Central Bank credit; the deficit of the current account of the balance of payments has been reduced from 3.5% of GDP in 1984 to an estimated 2% of GDP in 1985. However, the stabilization program is encountering difficulties. First, the Government has been unsuccessful in containing the spending of some public enterprises and provincial governments. Unless additional measures are taken, the public sector deficit will exceed the Fund targets. Second, interest rates, although lower, now stand at 3% per month and discourage private investment. Third, the deficit in the current account of the balance of payments is expected to widen again in 1986, primarily because of continued deteriorating terms of trade and recent floods which have hampered agricultural production.

II. Objectives of the Medium-Term Program

7. In the design of a program for the medium-term recovery and development of the economy, it is important to recognize that the continuation of the Plan Austral is a necessary precondition for any program. Thus, even a base case scenario will require a continuing series of policy steps building upon and strengthening the program initiated in mid-1985. In laying out the scenarios of the medium-term program, three objectives have been established. First, recovery of Argentina's growth performance to the traditional 4-1/2%. Second, that a modest but steady improvement in real per capita consumption is a necessity for the social and political maintenance of the consensus behind any economic program. Third, that the ratio of debt to exports must be brought down to levels where the normal role of foreign capital in the Argentine economy can be reestablished.

8. Real per capita consumption has been declining for some time and in 1985 was lower than any time in the past 15 years. With interest payments on foreign debt currently absorbing almost 40% of savings and 7% of

GDP, it will be difficult to find much scope for improvements in real consumption. Nevertheless, the base case scenario explores the costs of providing a steady but modest improvement of 1% per year within a 3% real growth rate, while the high case explores the possibilities of accelerating this to 2% per year within the next decade in the context of a 4-1/2% real growth rate. On the external side, the objective is to reduce the burden of debt from its current high ratio of 5 times exports to more manageable, but still high levels of roughly 3 times exports by 1990, with the further objective of approaching ratios significantly below this during the following decade. Finally, it should be emphasized that the magnitude of the difficulties that the economy is currently experiencing is such that the differences between the base case--maintenance of the Plan Austral--and the high case--maximum effort--are fairly small in terms of results until 1989-90.

III. Implications of the Objectives of the Medium-Term Program

9. In assessing the implications of the objectives of the medium-term program, two key structural characteristics of the economy must be explicitly recognized. First, the economy is a relatively mature one with relatively small increases in population and labor force which, over the past half century, it has never exhibited the high growth rates characteristic of more normal developing countries. Thus, it would be unrealistic to expect growth rates of GDP to exceed 5% over a sustained period, even under conditions of maximum policy efforts. The second factor is the immense size of the external debt, equivalent to two-thirds of GDP and five times the size of exports. Even under the Plan Austral the economy does not generate enough surplus on the balance of payments to cover the interest on its debt. Thus, any program, even under the best of policy conditions, will require net lending to Argentina (either as fresh money or as capitalization of interest) for at least the next 3-4 years.

10. It is also important to point out that in our judgement it is necessary that the Plan Austral, in itself a bold and significant policy effort, be maintained, except for the wage price freeze, which should be phased out during 1986. Thus, we have taken this as our base case rather than setting forth the very dismal scenario that would emerge if we were to extrapolate the performance of the 1980-84 period, which would involve a stagnation in real growth, a continued decline in real per capita consumption, a highly protected and inefficient domestic economy, continued high debt to export ratios, and, in all likelihood, continued political instability. Thus, there is perhaps a less striking difference between our base and high cases than in other countries where similar analyses have been made.

11. Investment in Argentina has in recent years been an extremely low share (13%) of GDP and has been characterized by inefficiency with high ICORs. The program for the future does not call for massive new investments across the board, but rather selective investment in key areas, both public and private, with a focus on increased efficiency. Thus, it is projected that in the base case investment might productively be increased to about 15% of GDP by 1990 and about 17% by 1995 with private sector investment (currently 60% of the total) increasing about twice as fast as

public. In the high case, the ratios to GDP are only slightly higher (16% and 18%) but the ICORs are significantly lower as policy reforms, for example in the energy sector, are implemented allowing a significantly more efficient use of capital stock.

12. Roughly 40% of domestic savings is now being used to pay interest on external debt. Even under the best of policies it is not likely that this can be reduced to less than 20% before 1990. Saving itself, under either scenario, should show a modest improvement in its share of GDP in response to measures to reduce the public sector deficit and encourage private sector savings. The latter could be supported by the financial sector reform as well as by the improved investment climate generated by the policy package.

13. The exchange rate established in the June 1985 measures represented a more than competitive parity for the Austral. While there has been a modest domestic inflation since that time, the currency has not, in the opinion of the IMF, yet moved to a non-competitive position. It is expected, however, that during the period covered by our projection, the authorities will take the required policy measures, including--if necessary--periodic adjustments of the exchange rate in order to maintain the approximate competitiveness of the currency that existed during the latter half of 1985.

14. The key to Argentina's recovery and to the reduction of the heavy debt burden is the performance in the export sector. This is made all the more difficult by the relatively small degree of openness of the economy; exports are currently only 14% of GDP. In addition, the current weak position of the commodities that make up most of Argentina's exports does not augur well for rapid improvements in earnings in the short-run, even with maximum productive efforts by the country itself. Given that beef, wheat, soybeans, and sorghum are key commodities, it is unlikely that after 1985-86 improvement in production there will be more than 2-3% long-run real growth in exports. In the high case, full implementation of our policy recommendations in agriculture, trade, and more importantly in the energy sector, could result in real growth of exports in the 5% range.

15. On the import side the projections imply different assumptions on opening up the economy and, thus, on the share of GDP, given a competitive exchange rate and the phasing out of import restrictions. Under the base case, because of the necessity to have a modest improvement in per capita consumption, total external debt rises until 1992; in the high case this peak takes place until 1990, when the country begins to pay its debt. In the high case, the projection also assumes that there will need to be a significant opening up of the economy, and in particular, an acceleration of the value of capital goods imports, reflecting a capital deepening.

16. External debt, including short term, is currently just under US$50 billion. The debt service ratio, including short-term interest payments, is currently over 100% of exports.Not only does this debt present a serious impediment to the resumption of normal international financial relations for Argentina, but it also represents a heavy burden on domestic resource mobilization. At the present time, the interest payments on all of Argentina's debt are over US$5 billion, while the resource surplus on

the trade account is only slightly above US$3 billion. Thus, not only must exports grow, but efforts need to be made to reduce the size of the debt in relation to the economy. The implication of the current situation is that as there is an insufficient resource surplus to pay interest on the debt at least for the next two to three years, Argentina will have to arrange for lending to cover this requirement. Reschedulings, whether officially or de facto, will be required throughout the rest of the 1980s with the possibility of some potential for repayment of commercial bank lending during the 1990s.

17. The projections are based on the assumption that all debt to commercial banks as of the end of 1985 is serviced on interest with amortization being fully rolled over, and all other debt is fully serviced including all new debt from commercial banks. When the projections reach the point that all such payments can be made without fresh borrowing, the surplus is assumed to accumulate in reserves. At that point four choices will be available to the Argentine authorities by 1992 in the base case and by 1990 in the high case to: (i) repay principal on pre-1986 commercial bank borrowing; (ii) increase imports with a view to accelerating growth; (iii) increase imports so as to improve consumption levels; and (iv) accumulate foreign exchange reserves and earn interest on them. There is no clear-cut case for preferring any one of these alternatives. It is quite probable that increased investment in the Argentine economy, beyond the point where growth is in the 4-1/2% range, would not increase growth further, but rather lead only to increased inefficiency in the use of capital. Repaying the principal of the pre-1986 commercial bank debt is certainly possible, but would only be desirable if it would enhance Argentina's creditworthiness. Increasing reserves is not an end in itself, it simply increases the resources available to be spent and the temptation to spend them on large projects. If higher consumption levels than those projected in the above analysis are politically necessary, then the external resource requirements to effect full recovery will be higher. Finally, the authorities could certainly use the resources to increase consumption even earlier than projected, which while certainly attractive, could lead to increased inflationary pressures on the non-tradeable sectors of the economy. Clearly, the authorities, when the time comes, will utilize a mix of the four alternatives; the point is that this should be done in a careful and balanced fashion. The purpose of the present exercise is to indicate at what point in time such an option might be available rather than to specify exactly what choices should be made. Thus, the choice of repaying debt has been adopted in our projections on a purely notional basis.

18. In recent years, Argentina has been characterized by high fiscal deficits and, as stabilization was set in place, by very low ratios of money to GDP--M1 to GDP was as low as 3% and will probably finish 1985 at about 6%. The dilemma facing the authorities is how to increase the availability of money in the economy without raising inflationary pressures. Accordingly, the money expansion must be very modest and in both scenarios we have assumed that the policy packages are consistent with an expansion of the money to GDP ratio to 10% of GDP over the next four years. The fiscal deficit will be very difficult to reduce over the short run given

the high debt servicing burden placed on public finances and the structural problems in state enterprises, particularly YPF (Yacimientos Petroliferos Fiscales). We have thus assumed that the deficit can be reduced to 3% of GDP during 1986, but that in the base case it will fall no further. In the high case the policy reforms, particularly in YPF, should allow a further drop to 2% of GDP, but this, we believe, is a reasonable and attainable long-run structural ratio of the deficit.

IV. Policies, Institutions, and Priorities

19. Argentina has the potential to reverse the current recessionary trends in economic activity and gradually achieve respectable growth rates while reducing its debt to exports ratio. Fulfillment of this potential in a high case scenario is predicated on the adoption of comprehensive policy reforms.

20. In a first stage, the Government has put into place a comprehensive program to stabilize prices, reduce the fiscal deficit and strengthen the external accounts. The next hurdle that needs to be overcome is the transition from a wage and price freeze (where, in effect, not all prices and wages have been frozen) to a regime of price flexibility. To proceed on this course without once again destabilizing the economy, the Government needs to undertake measures which should permanently reduce the fiscal deficit and avoid using Central Bank credit to finance it, so as to create an environment for breaking medium-term inflationary expectations as it implements a concerted and gradual phasing out of the freeze. Such a phasing out should be done gradually and with sufficient support from producers, retailers and trade unions to avoid a rekindling of inflation.

21. The Government has stated its intention to address the root causes of Argentina's economic woes through comprehensive medium-term program of structural reforms. At the moment though it is still seeking its way, the elements for an integrated program have not yet been put together. It is considering to eliminate most quantitative restrictions on imports and replace them by tariffs. It is also planning to reduce state participation in the industrial and petroleum sectors. Further, it has indicated interest in Bank support for the privatization of its petrochemical holdings in the Fabricaciones Militares complex. However, the Government is moving only slowly in opening up petroleum exploration and exploitation for the private sector; likewise, in telecommunications, it has decided to entrust the expansion of the seriously defective telephone network to a public sector company (ENTEL) that has been unable to operate the existing systems satisfactorily. The Government needs to act on several fronts simultaneously: improve the incentive system for the private sector, define a policy for the public sector, streamline public expenditures, eliminate distortions in the financial sector, and strengthen the infrastructure required to support exports. The following paragraphs summarize our judgment on the relative importance of the policies and measures required to achieve the objectives mentioned above.

22. The Government should give first priority to eliminating export taxes and quantitative import restrictions. As of October 1984, the average import tariff was about 23%. A comprehensive trade policy reform,

including lower rates of effective protection only seems feasible once the economic recovery is well under way. Meanwhile, a gradual process of rationalizing the trade regime should support a concerted major drive to promote industrial exports. We have estimated that such a program, which could be supported by Agricultural Sector, Trade Policy and Export Promotion Loans, could generate incremental foreign exchange earnings of about US$1.2 billion from agricultural exports and of US$1.3 billion from industrial exports by 1990; however, this would require new offsetting fiscal measures.

23. Policy reforms in oil and gas are crucial for the high case scenario to materialize. The Government has indicated its intention to allow for a broader role of the private sector, both foreign and local, in the development of Argentina's hydrocarbon resources. However, it has been slow in defining specifics and in taking concrete action. Key among the requirements for the promotion of gas and oil developments are more attractive and stable incentives for the private sector, award of attractive new exploration and exploitation contracts, limitation or elimination of convertibility risk, access to domestic credit (i.e., "apex" financing arrangements) and rationalization of the price structure of hydrocarbon products in line with economic costs. There are also possibilities to enhance the participation of the private sector in the gas transportation and distribution system. We have estimated that Argentina has the potential to export around 70,000-120,000 barrels per day amounting to US$0.6 to US$1.0 billion of crude oil/petroleum (at US$24 per barrel) products by 1990. Moreover, annual investment requirements during 1986-90 of about US$1 billion for petroleum and US$0.5 billion for gas cannot be met by the public companies. At the same time YPF is the single major source of the public sector deficit, because it keeps for itself the taxes it collects for the Central Government, since its expenditures are much larger than its revenues. Bank lending in support of rational hydrocarbon development policies could include Refinery, Supplemental Oil an Gas Sector (policy-based), Gas Pipeline and Oil and Gas Private (project financing) Loans.

24. Eliminating the existing distortions which do not allow capital markets to operate efficiently will be a key to stimulating investment for capacity expansion. However, because of the risks of a financial crisis involved in a comprehensive financial sector reform, the needed reform has to proceed in stages. First, real interest rates could be reduced sharply if longer-term inflationary expectations were to be broken. A fall in real interest rates would also become possible by removing present surcharges, shifting the burden of reserve requirements to sight deposits with very low requirements on time deposits, and reducing controls to direct credit. The Government would also need to strengthen the supervisory role of the Banking Superintendency. In particular, the Government should not give preferential treatment to government banks. Second, the Government should initiate a program to restructure the sector through mergers and acquisitions by means of increasing minimum capitalization requirements and temporary fiscal measures to promote consolidation. However, the Government needs to proceed with caution, perhaps first concentrating on public sector banks, particularly the provincial banks that are inefficient and close them down. A proposed Financial Sector Reform Loan has tentatively been included in our program.

25. A framework for reforming the public sector should include the medium-term role of the public sector in the productive areas; namely, to both restructure (oil and gas, railways and telecommunications) and privatize public sector enterprises (petrochemicals and steel). Moreover, its share of public sector investment in total investment should gradually decrease. The public sector should not have preferential access to credit. Budgetary policy should be such that only transfers for equity take place and that operating losses of enterprises or the public banks not be financed by either the Central Bank or the budget, except on a temporary basis. At the same time, the public sector should have freedom to set its prices within certain regulatory limits for monopolistic services. Finally, enterprises should be managed as commercial entities, including policies over wages, recruitment and dismissals. A proposed Technical Assistance Loan would assist in formulating the above framework.

26. In the context of implementing the reform of the public sector, the Government also has to place emphasis on reorganizing its own house. The thrust of this effort should be to reduce public sector employment (through attrition) and to improve the efficiency of public sector enterprises including adequate cost recovery policies. Analytical work to improve the efficiency of public enterprises [especially YPF, ENTEL, Railways, SOMISA (steel)] has been initiated. Preliminary results indicate that restructuring (technical, financial and organizational/management) of these enterprises could lead to major gains in their efficiency and competitiveness, while at the same time strengthening public sector finances. The Bank could support restructuring, which would be a lengthy and difficult endeavor through sector loans in transport, energy and enterprise specific loans for SOMISA and ENTEL.

27. Similarly, the Government will need to prepare and review carefully the priorities of a medium-term public investment program. Our recent review of a preliminary investment program has indicated the following priorities in the transport and energy sectors, which account for about half of public sector investment: (i) improvement of port services; (ii) reconstruction/maintenance/graveling of high-trafic roads; building of feeder roads for the main export corridors; (iii) enhanced oil recovery/liquid extraction and gas gathering projects, acceleration of oil and gas pipeline construction; (iv) reinforcement of power transmission/distribution lines. The Government has to strike a better balance between new investment and maintenance; to introduce uniform investment criteria; define priority projects; and establish a central review for all public investment projects. In this connection, a central project processing/monitoring unit would go a long way in helping to implement the criteria and investment priorities that are agreed upon. As regards investment financing, improvements in tax administration and rationalization of public tariffs should be undertaken simultaneously with the elimination of earmarked funding (special funds) which are not conducive to efficient resource allocation. The Bank could support government efforts in this context through Technical Assistance, Bahia Blanca Ports I/II, Yacyreta supplemental, Power Distribution and Transport Sector Loans.

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V. Scenarios

28. This section is a description of the type of evolution of the economy that we expect to see under the two different policy scenarios. The differences in the scenarios are essentially a matter of degree in timing and intensity of implementation of policy reforms, which would condition, again as a matter of degree, a return of confidence and, consequently, direct private investment (both domestic and foreign). As was pointed out earlier, the base case requires the maintenance of the Plan Austral and thus needs a significant degree of continued policy action on the part of the authorities. As noted, a true base case would imply a return to the chaotic and disastrous policies of the early 1980's and would be characterized by escalating debt, high inflation, declining per capita consumption, and stagnant GDP. The Plan Austral represents a bold repudiation of these policies on the part of the Argentine people and an implicit assertion that the Plan, even with its present and future sacrifices represents a minimum acceptable state of the economy.

29. The central sequence of policy actions and responses in the economy centers on the necessity at first on increasing exports as rapidly as possible so as to address the overriding balance of payments and debt constraints. Thus the policies in the immediate future are aimed at exportables and at the incentives to export. As the economy has a moderate degree of unutilized capacity in most sectors, the initial thrust will be on pricing. To this end the agriculture policies are directed at a reduction in export taxes and a reformation of credit policies. Similarly in the manufacturing sector where trade policy reform is an early priority. In both these sectors there is enough capacity that it will be several years before new investments need come on stream. In order to effect this however, it will be necessary for a reform of the financial sector to have taken place, ideally by early 1987, so as to lower the real cost of capital to investors while simultaneously increasing the incentives to savers. A second key to the recovery will be the oil and gas sector. Here the country has a substantial potential, not only for natural gas, but also for petroleum. In the short-run the issues can best be addressed by the encouragement of the private sector in the industry, by allowing the private sector into the exploration and development phases, by reducing part of YPF's investment program (drilling and exploitation) and giving the private sector the responsibility to undertake it, and by encouraging technical developments in the extraction of existing wells. Finally, there are issues that affect the fiscal strength of the country including an early start on attaining adequate pricing in natural gas, power, and water and sewerage, improved planning, the scaling down of the public investment program, and monitoring of public sector investment. This latter program should not only be aimed at allowing the private sector greater participation in productive sectors, but also in focussing the investment of the public sector in key infrastructural areas (such as ports and transport corridors).

30. In the high case scenario, a very significant policy measure concerns the building of gas pipelines and this requires an early settlement of the COGASCO issue. This policy initiative will allow a dramatic change in the energy accounts of the balance of payments, by allowing the gas associated with petroleum deposits to be taken off and thus allowing a substantial increase in petroleum output. In addition this scenario will

require high levels of private investment in the sector. In both cases, it would be necessary to improve extraction from existing wells, private sector participation in exploration and development and moderate private sector investment. In the agricultural sector, while the base case would only envision export taxes being dropped to the May 1985 level, the high case would phase out most of them and would focus on public investment in the transport infrastructure between the producing areas and the ports. In the trade field, the base case will require policy actions. The high case assumes a significant opening up of the economy and may require further improvements in the competitiveness of the exchange rate, but will certainly require coherent and stepped-up efforts on export promotion and improved management and recapitalization of enterprises. In the base case scenario, adequate pricing policies will be requiredin the power sector. In the high case scenario, the power sector will require expanding the transmission and distribution network and the completion of ongoing power generation projects (including Yacyreta) based on adequately projected demand requirements. Finally the distinguishing characteristic of the high case scenario will be the expanded and enhanced role that the private sector must play in the economy. Private investment must double in real terms within the next seven years. This can only take place with a coherent and productive environment for the private sector coupled with an efficient financial system.

VI. Action Program

31. The policy reform proposals included in the high case scenario should be implemented on the basis of annual action programs. This section outlines in detail the annual action program for 1986. A summary of the annual action programs for 1987-90 is outlined in the attached Policy Matrix (Annex I) These of course would be reviewed and modified to take into account the results of the implementation of each annual action program and changes in the external environment. Discussion of the policy requirements under the base and high case scenarios for 1986-90 is included in Section V above. A summary discussion of sector policies is included in the attached Sector Policies (Annex II).

1986 Action Program

32. The 1986 program would focus on: (a) agreement on a medium-term macroeconomic program; (b) preparation of a medium-term public sector investment and financing plan and external borrowing programs; (c) adoption of revenue and expenditure measures required to meet the targets under the Government's stabilization program; (d) gradual phase-out of the wage and price freeze; (e) exchange rate measures to maintain Argentina's international competitiveness as required; (f) improvement of the effective exchange rate in agriculture; (g) gradual elimination of about half of all import prohibitions and quantitative restrictions; (h) improving the administrative mechanisms of trade management; (i) facilitate financing for exports; (j) initiate support of export services as part of export promotion; (k) initiate reforms in the financial sector, and (l) introduce measures which will produce a structural reform in the operation of enterprises in the energy sector. More specifically, this would require the implementation of a number of sectoral actions.

33. Agriculture: (i) removal of the temporary increases in export taxes imposed in June 1985 (see para. 36 for offsetting revenues); (ii) removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985 and redesignation of tractors and agricultural machinery from the "prohibited" to the "free" classification for imported goods; and (v) initiation of studies to promote exports and improve efficiency in the sector.

34. Trade: (i) import liberalization through the elimination of most import licensing requirements: (a) reclassification of about 50% (2,000) tariff positions from prohibited to free and partial replacement by tariffs; and (b) reclassification of about 50% (650) tariff positions from prior consultation to free and partial replacement by tariffs; (ii) achievement of free trade status for export industries, through the reform of the temporary admission regime for imported inputs, along the following lines: (a) simplification of administrative procedures; (b) guarantee of automatic access for any products; (c) coverage of indirect exporters; (d) extension to capital goods used for export production; and (e) extension of the tax reimbursement scheme to exports processed under the temporary admission regime; (iii) simplification of export procedures, eliminating all unnecessry interventions by public sector agencies; and (iv) preparation of terms of reference for studies needed to support the adjustment process: (a) study of tariff protection with a view to actions that will reduce tariff dispersion; and (b) study on the indirect tax content of exports, with a view to actions to rationalize the system of tax rebates to exports, as well as strengthening it vis-a-vis trading partners that might be tempted to impose countervailing duties; (v) removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; (vi) facilitate financing (pre- and post-shipment) by banks; and (vii) develop a common integrated data base on markets and products for exporters.

35. Financial System: (i) lowering reserve requirements; (ii) reduce controls to direct credit; (iii) preparing a program for rebuilding of the financial sector; and (iv) strengthen the supervisory role of the Banking Superintendency.

Public Sector

36. Fiscal System: (i) identification of alternative sources of fiscal revenues and taking appropriate measures as needed to maintain the fiscal deficit at levels commensurate with the ceilings of the Government's stabilization program (estimated at about 3% of GDP for 1986); (ii) satisfactory progress on a program for preparation and implementation of federal land tax; and (iii) tax administration: (a) initiate the improvement of information flow by unification of taxpayer identification for each separate tax collecting entity; phase out expensive visit system in favor of distribution of information on cross-compliance; increase penalities for evasion; and concentrate audit efforts on VAT; (b) eliminate tax amnesties; and (c) focus excise tax collection on commodities where the Government has direct control over the collection.

37. Public Enterprises: (i) decision to restructure and privatize; (ii) initiate reduction of employment through attrition; (iii) introduce

managerial accountability and cost accounting; (iv) initiate real tariff increases in electricity and water supply enterprises; (v) minimize coal investments; (vi) postpone major hydroelectric projects (Yacyreta); (vii) cancel the expansion of the petrochemical production capacity in Bahia Blanca, of the SOMISA new sheet steel rolling mill and the shipyards expansion; and (viii) establish clear criteria for public enterprise management on a commercial basis.

38. Energy: (i) reduction of YPF budget deficit (from projected US$1.1 billion to US$0.4 million) through: (a) cuts in the investment program. Cut proposed program of US$1 billion to US$600 million (with the private sector undertaking these investments) by reducing exploration and production activity from a proposed 130 exploration and 850 production wells to 50 exploration and 250 production wells, focussing on high-yielding fields and secondary recovery projects making maximum use of existing shut-in wells and well repairs. New oil production contracts with private companies would supplement YPF's production efforts. Continue infrastructure investment, mainly refinery conversion, which should be completed on time and could not be farmed out to the private sector at this stage; (b) cuts in the operating budget. Establish action plan to achieve operating cost reductions estimated at about US$0.3 billion through savings due to reduced drilling activity (US$0.2 billion) and efficiency improvements (US$0.1 billion); and (c) introducing a monitoring mechanism. Establish independent monitoring body reporting to the Ministry of Economy which supervises YPF's budget programs on a continuous base and approves/countersigns major decisions/expenditures; (ii) private sector oil exploration and production: (a) new private oil production contracts. Establish action plan to farm out explored areas to local and foreign oil companies under production contracts. Achievable private sector investment estimated at US$200-300 million annually; (b) private oil exploration contracts. Complete first bidding round for 32 areas (of 164 already defined areas) for new risk contracts by February 1986. Complete second round for another 30 areas during 1986. Estimated investment possibilities: about US$200 million annually once drilling phase of awarded contracts starts; and (c) financing of private sector operations. Allow export of crude oil or petroleum products for limited recourse financing schemes. Improve disbursement procedures for World Bank funds managed by BANADE. Utilize IFC funds as matching funds to mobilize additional on-lending loans from commercial banks; (iii) YPF organization improvement: (a) Establish action plan to implement accounting and financial management systems to allow cost control by activity and clarify accountability of YPF managers; and (b) institute a high-level government committee to prepare options and approaches to restructure YPF and to introduce workable competition in the petroleum sector; (iv) gas sector: (a) begin Northern Pipeline expansion with clear schedules and budget provisions; (b) prepare transmission pipeline expansion program (Central West and new Western Pipeline); (c) resolve the COGASCO dispute in 1986; and (d) introduce new financing schemes such as limited resource financing guaranteed by petroleum export revenues; and (v) power sector: continuation of real tariff increases.

39. Water and Sewerage: Continuation of real tariff increases.

VII. Difficulties in Implementing Policy Reform

40. The proposed policy reform program outlined in the preceding sections constitutes a major task. With the exception of privatization, the proposed policy reforms in the agriculture, trade, energy and financial sectors are necessary for the high case scenario to become viable.

41. The reform of agricultural sector policies will be criticized by the conservative agricultural producers who are dead set against a land tax. Within the Government, at a time of great fiscal stringency, the Secretary of the Treasury is justifiably uneasy about the elimination of taxes that are very easy to collect (export taxes) and their replacement by a new tax that may prove harder to collect (the land tax).

42. Trade policy reform is an extremely sensitive area. The previous import liberalization attempt was a bitter disappointment: entire industries disappeared, industrial employment declined in absolute terms, and small and medium scale industries were particularly hard-hit; and the country had nothing to show for it. Thus, any effort perceived as reviving the "Martinez de Hoz policies" would be doomed to failure now. For this reason, the proposed program of policy reforms focuses on achieving free trade status for export industries, shying away from a comprehensive tariff reform that would decrease the already low average effective protection and its dispersion. This would be a way of maintaining the dialogue open on an issue whose sensitivity might diminish in a few years. Proceeding differently--that is to say, raising the issue of decreases in average effective protection at this point--would be extremely counterproductive. Business and labour leaders would present a united opposition front. The better investment climate that the Government is painfully trying to reconstruct would deteriorate sharply and the Bank's policy dialogue would be seriously jeopardized. Yet it must be recognized that so long as the import regime remains restrictive, additional external financing under the Baker proposal or repatriation of Argentine assets now held abroad might have inflationary consequences.

43. The major reforms proposed in the energy sector are likely to provoke opposition from several sectors. Drilling contractors which now execute about half of YPF's annual drilling program, will vehemently oppose any cuts that jeopardize their service contracts. This would be supported by provincial governments in oil-rich areas if reduced state production activity resulted in a loss of royalty payments and reduced employment of workers in the oil service industries. These concerns could be addressed by awarding a substantial amount of production contracts to private sector firms, which would shift risk and financing burdens to the private sector. In particular, foreign firms would be able to service capital more easily and could improve production efficiency more quickly than local firms. Moreover, any privatization of oil production, introduction of more competition or the restructuring of YPF, are likely to encounter resistance from YPF's management, unions, and political forces within the Radical Party (traditionally supporting public sector dominance of oil and gas activity). This could be addressed by the creation of new private sector jobs through the increase in private sector activity and by improving performance incentives within YPF. Basically, however, these groups will have to be convinced that the proposed policy reforms will

improve the Government's fiscal deficit and the balance of payments prospects.

44. The reforms proposed in the transport sector will receive strong opposition from the Transport Secretariat (within the Ministry of Public Works and Services) which does not concur with policy recommendations originating from development institutions. In addition, major changes in the railways will be difficult, given that these inevitably will require a massive reduction in personnel.

45. Financial sector reform is likely to be resisted by the owners and managers of those financial institutions that are least likely to survive and by the public sector-owned provincial banks. Since restructuring will unavoidably imply the closing down of some institutions and branches, it must be expected that, the banks' employees unions will agitate to defend their members' jobs. Pressure will be applied on the Government to absorb the redundant employees (about 30,000) which it will not be in a position to employ.

46. Privatization efforts in all sectors are likely to be resisted, even by some groups within the Radical Party. The issue is complicated, moreover, by the administration's reluctance to antagonize the armed forces unduly, and the fact that some of the more obvious privatization cases are the Defense Ministry's steel and petrochemicals industries. Even in the event that privatization could take place, the availability of buyers and lack of financing could pose a serious constraint to divestiture.

VIII. Monitoring of Policies

47. The Bank would follow the Colombian model to monitor the progress of the Government's medium-term program. However, different from the Colombian case, we would expect that the Government enter into formal standby agreements with the Fund. Such monitoring would be implemented through yearly assessments of a medium-term macroeconomic and public sector investment programs. This would include the adoption and direction of policies to ensure the programs' future viability. Consideration of policy based loans which would include specific agreements on agricultural, trade, energy and financial sector policies and public sector reforms, and on a successful implementation of the above mentioned programs. We would push to reach an agreement with the Government on the above before we present a proposed Trade Policy Loan to the Board. We would also include in the programs specific agreements on the adjustments of prices of public utilities to appropriate levels, together with corrective actions on the overall economic program as required, and actions to increase the role of the private versus the public sector, including foreign investment. On the basis of the above, we would undertake regular supervisional exchange of views with the Government. The Bank's yearly assessment of the macroeconomic program would take into account the IMF's review of its stand-by agreement with the country, particularly as it relates to targets on net international reserves, the fiscal deficit, total credit of the Central Bank, net credit of the Central Bank to the public sector and the level of public sector debt on a quarterly basis. The Bank's overall assessment would incorporate the IMF's view on progress with respect to achieving and

maintaining export competitiveness in the current stand-by, and in subsequent ones, to be negotiated once the current one expires in March, 1986. As part of this process, we will propose to the Government that it prepare and send to the Bank two reports on a yearly basis, summarizing the status of implementation of the medium-term program to be agreed with the Government. The first status report would also serve as a basis for a mid-term review. These reviews would also form the basis for the release of the tranching under new policy based lending.

IX. Stabilization: Relationship with the IMF

48. The principal aim of our relationship with the Fund will be to develop an operationally effective understanding before their next stand-by negotiation (March 1986). The purpose of the proposed relationship will be to: (a) agree on a medium-term framework necessary for the country to become creditworthy and resume real economic growth; (b) agree on a stabilization approach that is compatible with growth objectives; (c) receive their input and support to ensure that the Government's medium-term investment program will be financially viable; (d) define the respective roles in monitoring; and (e) incorporate the IMF's view in progress with respect to stabilization and maintenance of export competitiveness in the Bank's overall assessment of the adequacy of the Government's medium-term macroeconomic program. Consistency between stabilization and medium-term growth will be essential, and thus the Bank's and Fund's programs should be worked out concurrently. The IMF would be responsible for the stabilization aspects of the medium-term program; the Bank would be responsible for the growth and efficiency aspects (Section VIII above). Continuous consultations would take place to ensure that stabilization and growth objectives are compatible with each other. In this connection, Fund/Bank consultations would also focus on the stabilization issues to be covered by Fund missions and on the issues which Bank economic missions and policy based lending operations would cover. The Fund's expertise in the fiscal area would be sought to complement our analyses regarding the introduction of new taxes in our policy based lending and for the supervision of the tax policy and tax administration activities in the proposed Technical Assistance Loan.

X. Financing Requirements

49. Given the above objectives, policies, and constraints, it is estimated that between 1985 and 1990, even with the best achievable policy package, the Argentine economy will require net flows (excluding IMF and direct foreign investment) of some US$8.7 billion, the bulk of which would have to be concentrated in the 1985-87 period. With the more modest policy package the flows would be more in the range of US$9.5 billion. It is envisioned that this would require gross disbursements of about US$18 billion and commitments of about US$14-15 billion in either case. The Argentine economy itself has not been characterized as one with large trade deficits. The country's indebtedness increased during 1979-82, mainly because of a misguided policy experiment which was followed by a huge capital flight and because of an unfortunate military action. For this

reason Argentina may develop the capability to repay its external debt if policies appropriate to fully utilize the country's potential are implemented, provided the Government does not opt for substantially higher consumption levels. In the base case, longer maturities for fresh money from the commercial banks would be required as compared with the high case where such borrowings could be repaid over a shorter period of time. In the base case, some 60% of the net flows would have to come from the commercial banks, concentrated mainly in the early years of the program. In the high case, the commercial banks' share would be somewhat lower (about 50%) as the potential to service the debt fully would appear sooner (1988 as compared the base case (1990). World Bank commitments for 1986 would amount to about US$630 million in both cases, since the level of commitments would be significantly firmed-up. From 1987 onwards, commitments would average US$500 million per year in the base case; and in the high case, US$800 million in 1987 and US$900 million per year during 1988-90. In the base case the World Bank share of debt outstanding and disbursed would be under 4% while in the high case, the World Bank share would go up to 5%.

ARGENTINA - PROPOSED MEDIUM-TERM ADJUSTMENT AND GROWTH PROGRAM

High-Case Scenario

Main Goals: (1) To restore and sustain real economic growth of 4% on average during 1986-90, and 4.4% during 1991-95.

(2) To expand exports in real terms by 5.4% on average during 1986-90.

(3) To maintain a sound balance of payments position, consistent with a reduction in the debt to exports ratio from 5% in 1985 to 3% in 1990.

Note: * indicates actions to be implemented in one year; —— indicates actions covering several years.

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
A. TRADE, INDUSTRY AND AGRICULTURE								
1. Exchange Rate Policy	Maintain international competitiveness	Crawling peg devaluations during first half of 1985; 18% devaluation in June 1985; continuing depreciation of the real exchange rate vis-a-vis major trade partners	Maintenance of competitive exchange rate policy through periodic adjustments which are equal to the difference between domestic and international inflation.	——	——	——	——	——
	Improve the effective exchange rate in agriculture	Export tax on wheat reduced from 26.5% to 15% (September 1985); smaller reductions in other commodities	Phased reduction of export taxes on agricultural commodities by 1988 to no more than 50% of the rate in force on May 1,1985; by 1990 to 5% of agricultural exports; and by 1991 complete elimination.	——	——	——	——	——
	Improve the effective exchange rate in industry	Export taxes on agroindustrial exports eliminated (August 1985)	Full rebates on direct and indirect taxes paid by exporters.		*			
2. Import/Export Regime	Eliminate prohibitions and quantitative restrictions		Phased elimination of most import licensing requirements: (i) reclassification of 4,000 (100%) tariff positions from prohibited to free list and partial replacement by tariffs	——	——			
			(ii) reclassification of 1,300 (100%) tariff positions from prior approval to free list and partial replacement by tariffs	——	——			
			(iii) redesignation of tractors and agricultural machinery from the prohibited to free list.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
3. Export Incentives	Provide inputs for exporters at world prices Reduction of import tariffs Improve the administrative mechanism of trade management Provide export support services and adequate and timely information		Reform of the temporary admission regime for imported inputs: (i) guarantee of automatic access to any input;	*				
			(ii) gradual coverage of first-line suppliers of exporters;		*			
			(iii) gradual extension to capital goods used for export production		*			
			Removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985	*				
			Preparation of studies needed (i) to rationalize the import tariff structure	———	———			
			(ii) to rationalize the structure of tax rebates for exports	———	———			
			Implementation of recomendations of above studies			———	———	———
			Simplification of export procedures, unification of agencies authorized to review and approve export applications	———	———			
			Formation of a joint organization to provide institutional support for marketing, storage, quality guarantee, legal assistance, lobby. Development of an integrated data base.	———	———	———		
4. Export Financing	Expand available resources		Removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; and encouragement of joint financing by banks	*				
			Review the level of financing subsidies.			———	———	———

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Allowance of export plans by firms as a basis to determine the amount of Central Bank credit lines for financing.		*			
			Broadening risk coverage of exporting firms.		*			
5. Agricultural marketing	Provide marketing infrastructure		Provision of market places and information for non-traditional agricultural products.		——	——		
	Expand transport and storage facilities		Promotion of private sector participation.		——	——		
6. Agricultural Credit	Financing increases in production.		Increase availability of short- and long-term credit.		*			
B. FINANCIAL SYSTEM								
1. Interest Rates	Reduce real costs of financing for investments.		Lowering reserve requirements on time deposits and sight deposits.	——	——			
2. Sector Restructuring	Create a healthier financial sector.		Increasing minimum capital requirements for financial institutions.		——			
			Temporary stock purchasing to facilitate adjustment and consolidation.		——	——	——	——
			Institutionalization of deposit and employment insurance systems.		——	——	——	
			Prepare a program for rebuilding of the financial sector.	*				
			Removal of the 2% ISSBE (Institute of Social Services for Bank employees) surcharge and its coverage by alternate fiscal measures.	*				
			Removal of the CRM (a device to reallocate differential reserve requirements).	*				
			Elimination of credit subsidies.		*			
			Reduce controls to direct credit.	*				
			Strengthen the supervisory role of the Banking Superintendency.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
C. FISCAL SYSTEM								
1. Tax Structure	Broaden the corporate tax base	Inclusion of rural properties to capital gains tax	Include profits on the sale of property		*			
	Improve the buoyancy of tax system, shift the burden to direct taxation		Elimination of most industrial incentive exemptions from VAT.		—	—		
			Focusing excise taxes on commodities where Government has direct control over the collection	*				
	Eliminate anti-export bias of the tax system		Introducing a federal land tax as export taxes are phased out		*			
2. Tax Administration	Improve the effectiveness of tax administration		Unification of tax payer identification for each separate tax collecting entity	—	—	—		
			Phasing out expensive visit system in favor of distribution of information on cross--compliance	—	—	—	—	
			Increased penalties for evasion and tax delinquency	—	—			
			Concentrating audit efforts on VAT	—	—	—	—	—
			Elimination of tax amnesties	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
D. PUBLIC SECTOR								
1. Central Govt., Public Enterprises and Investment	Definition of medium-term public/private sector roles		Decison to restructure and privatize public enterprises.	*				
	Improve efficiency of operations	A commission for the privatization of a group of public enterprises has been established.	Establish clear criteria for public enterprise management on a commercial basis.	*				
	Eliminate bottlenecks constraining trade expansion		Reduction of public employment through attrition.			—	—	—
		A set of studies to guide public sector reform has been initiated.	Wage differentiation and productivity bonuses.		—	—	—	
			Introduction of managerial accountability and cost accounting.	—	—	—		
	Phase-out public sector investment in non priority areas		Phasing out the production of goods and service lines.		—	—	—	
			Phasing divestiture of those enterprises that are not producing a true public good and/or service.		—	—	—	—
			Elimination of budgetary support to enterprises and of preferential credit.	—	—	—	—	—

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
	Mobilize and allocate resources to priority investments	National Development Council (CONADE) was reestablished to redirect public investment	Elimination of earmarked funds for non-priority projects.		*			
			Allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources; continuation of real increases in water and electricity tariff revenues; and preparation of a medium-term public sector investment program and financing plan and external borrowing program.	——— *	——— ———	——— ———	——— ———	———
2. Energy Sector	Better use of energy resources	Major cuts and postponements in several energy projects	Government decision on the expansion of the gas transportation system through private participation Solution of the COGASCO dispute.	*				
	Enhance the private sector's role and improvement of oil export possibilities	A five-year investment program for the sector is being prepared	Award new exploitation and exploration contracts for oil and gas to private firms.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Provision of safeguards against the risks of convertibility for foreign investors.	*				
	Improve the operations of state oil and gas companies		Reduction of investment and operating costs, financial strengthening and streamlining of organizational structures, accounting and control systems,	——	——	——		
			preparation of the restructuring options for YPF.	——	——			
	Mobilize potential financial resources		Adjustment of the price of natural gas taking its long run opportunity cost as a guide.	——	——			
	Promote energy conservation		Adjustment of the price of diesel as a function of the gasoline price,		*			
			preparation of the deregulation of oil and petroleum products.				——	——
			Design and implementation of an energy conservation program including price and taxation aspects.			——	——	
			Reviews of the energy efficiency of the power sector and of the possibilities for conversion and savings.		——	——	——	——
			Minimization of coal investments and postponement of major hydroelectricity projects.		*			

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
3. Transport Sector	Reduce deficits Provide adequate facilities for export trade		Assurance of adequate cost recovery in ports, channel dredging, and railroads and the introduction of road user charges.		—			
			Strengthening of transport planning and intermodal coordination.		—			
			Consolidation of agencies working in the same sector.		—	—		
			Railways: Overhauling company, cutting uneconomic lines, providing bulk freight, improving maintenance, elimination of electrification schemes.		—	—	—	—
			Highways: Better maintenance of main traffic corridors, concentration on feeder roads with higher traffic.		—	—	—	—
			Ports and Maritime Transport: Deregulation of offshore storage/shipping, containerization, tugboat services.		*			
4. Restructuring	Restructuring to improve efficiency and competitiveness of basic industries		SOMISA: cut costs, balance production lines and strengthen management/administrative practices.				—	
			ENTEL: improve operation and managerial efficiency.				—	
5. Privatization	Programs for privatization of public enterprises		Petrochemicals: (i) identify potential investors;		—			
			(ii) negotiate the sale price value of assets;				—	
			(iii) define the vehicle of transfer of assets to private investors.				—	

SECTOR POLICIES

1. This section identifies the major sectoral features that are necessary for policy reform to resume and sustain medium-term growth in Argentina. The purpose of the policy framework is to identify factors that have constrained growth, define policy objectives to eliminate such constraints, recommend specific policy changes, and indicate the possible effects of the proposed policy changes.

2. There are two major constraints for the resumption of sustained growth in Argentina: (a) the underlying distortions in the economy and (b) the inefficiencies in the operation of the public sector. Elimination of these constraints requires improving the incentives system necessary for a more intensive use of resources to increase production and exports, and undertaking a series of actions to improve the efficiency of the public sector. Carrying out these tasks will require the removal of distortions in the trade regime, the phase-out of the price freeze, restoration of domestic financial markets, the strengthening of the tax system and an overall improvement of the machinery of government, notably, sound public investment screening mechanisms, requiring public enterprises to operate like commercial entities, and defining an adequate framework for an expanded private sector role. Thus, this section is divided into two parts. Part I deals with the incentives system necessary for the resumption of growth and focusses on the elimination of distortions, reformation of domestic financial markets, and increasing the effectiveness of the tax system. Part II deals with improving the efficiency of the public sector, and focusses on the public sector investment program, with special emphasis on the energy and transport sectors which comprise over half of the public sector investment program. It also examines the possibilities of restructuring and privatization of public sector industrial enterprises as a means to help reduce the Government's financial burden and public sector deficits, and to increase industrial efficiency, competitiveness and exports.

I. IMPROVING THE INCENTIVES SYSTEM

AGRICULTURE

A. Analysis

3. The agricultural sector has been growing below potential as a result of pricing policies that have: (a) depressed domestic prices for outputs through export taxes; and (b) artificially raised the costs of some key farm inputs through import tariffs and quantitative restrictions. As a consequence, most farmers have opted for low-risk; lower-input technologies which led to a significant underutilization of production and export potential. Also, the inadequacy of transport, storage, information and marketing facilities has raised the final costs of agricultural products and discouraged the production of new commodities.

4. The total agricultural sector credit portfolio in each of the last few years has been less than 50% of the portfolio registered in 1980. The economic uncertainty has negatively affected the demand for investment credit. In the case of short-term production credit, inadequate supply by the Banco de la Nacion and provincial banks has been a constraining factor. The Government's stabilization program has restricted credit further. Yet, maintenance of the growth of the agricultural sector will require substantial increases in both production and investment credit.

5. Policy objectives in agriculture should focus on: (a) reducing export taxes on agricultural products, providing alternative sources of fiscal revenue to compensate for the export tax reduction so as to maintain the overall fiscal deficit at satisfactory levels; (b) rationalizing import laws and regulations on agricultural inputs, (c) strengthening marketing efforts; and (d) providing sufficient credit resources to the sector.

B. Policy Recommendations

6. Specific changes recommended include:

(a) phased reduction of export taxes on agricultural commodities. The timetable of such an export tax reduction should include by: (i) January 1986, the removal of temporary increases imposed in June 1985; (ii) end-1986, the reduction of export taxes to no more than 70% of the rates in force on May 1, 1985; (iii) January 1988, the reduction of export taxes to no more than 50% of the rates in force on May 1, 1985; (iv) January 1990, the reduction of export taxes to 5% of the FOB value of agricultural exports; and (v) January 1991, complete elimination;

(b) introduction of a federal land tax and of alternative tax provisions to compensate for the revenue losses resulting from the export tax reduction program;

(c) removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985;

(d) redesignation of tractors and agricultural machinery from the "prohibited" to the free imported;

(e) marketing policies should be geared to: (i) promote the participation of the private sector, especially cooperative organizations, marketing; and (ii) provide marketing infrastructure to promote the development of new agriculture commodities; and

(f) make adequate resources available to financial institutions to meet the demands for both long-term and short-term credit in the sector.

C. Potential Results

7. The policy reforms would stimulate increases in agricultural production and exports by: (i) increasing domestic producer prices, bringing them closer to international prices and improving benefit-cost ratios for investment and production inputs; (ii) reducing the subsidy from producers to consumers; and (iii) improved marketing and increased credit. The introduction of a production-neutral federal land tax substituting for production-negative export taxes would represent a structural change in Argentina's taxation system.

MANUFACTURING

A. Analysis

8. Argentina's manufactured exports have been influenced substantially by the overall trade regime, which has, in the last five decades, been largely protectionist, creating a strong inward-looking bias in the economy. Industrial export promotion has been generally seen as secondary to import-substituting industrialization. As a number of incentives and disincentives for different products were introduced, a multiplicity of effective exchange rates emerged, with exports of traditional goods receiving the lowest rates. The system ultimately succeeded neither in eliminating the anti-export bias in the highly protected industries nor in sustaining the traditional manufacture and agriculture. The incentives regime was rendered particularly inadequate during the 1977-81 import liberalization attempt. Argentina's manufacturing sector is still badly shattered by that unfortunate import liberalization experience, adopted concurrently with a revaluation of the domestic currency.

9. The present tariff regime has been in place since January 1984. As of October 1984 (the last date for which detailed information is available), the range of tariff duties was 0-38%, with an average rate of 22.8%. The average tariffs for the major sectors of the economy were, in fact, quite close to that mean, and they point to little dispersion of average tariffs across major economic sectors: in the agriculture and mining sectors, they are, respectively, 19.9% and 25.2%, while in the manufacturing sector, 22.9%

10. Manufacturing has the potential for export-oriented output growth, with attendant foreign exchange earnings and employment creation. The sector lacks a clear development strategy, institutional support and consistent policy signals. The main issue is how to redress the strong anti-export bias built onto the complex systems of tariff and non-tariff protection while maintaining an exchange rate adequate enough to restore export competitiveness. Policy objectives in manufacturing should focus on the implementation of an outward looking development strategy by introducing reforms to reorient the economy towards export promotion. This should include: (a) phased elimination of import prohibitions and quantitative restriction, and of export restrictions; (b) reorientation of export policies so as to reduce the discretionary element and provide automaticity and uniformity of access to incentives and foreign exchange in order to provide free-trade status for export industries; (c) improvement of the administrative mechanisms of trade management; and (d) preparation of

studies on tariff protection and rationalization of the system of tax rebates to exports as a basis for further policy reforms.

B. Policy Recommendations

11. Specific changes recommended include:

(a) the gradual elimination of most import licensing requirements as follows: (i) reclassification of about 4,000 (100%) tariff positions from prohibited to free and partial replacement by tariffs; and (ii) gradual reclassification of about 1,300 (100%) tariff positions from prior consultation to free and partial replacement by tariffs.

(b) achievement of free trade status for export industries, through the reform of the temporary admission regime for imported inputs as follows: (i) simplification of administrative procedures; (ii) guarantee of automatic access for any input; (iii) coverage of indirect exporters; (iv) extension to capital goods used for export production; and (v) extension of the tax reimbursement scheme to exports processed under the temporary admission regime;

(c) simplification of export procedures, eliminating all unnecessary interventions by public sector agencies;

(d) preparation of the following studies needed to support the adjustment process: (i) tariff protection, with a view to reducing tariff dispersion; and (ii) the indirect tax content of exports, with a view to rationalizing the system of tax rebates to exports, as well as to strengthen it vis-a-vis trading partners that might be tempted to impose countervailing duties;

(e) extension of export financing: (i) removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; (ii) facilitating joint financing by banks; and (iii) reviewing the level of financing subsidies; and

(f) establishment of an export assistance and information system: (i) allowance of export plans by firms as a basis to determine the amount of Central Bank credit lines for financing; (ii) broadening risk coverage of exporting firms; (iii) formation of a joint organization to provide institutional support for marketing, storage, quality guarantee, legal assistance, lobby; and (iv) development of a common, integrated data base.

C. Potential Results

12. The following projections for 1986-90 reflect the potential impact of the proposed policy changes, predicated on the basis of a timely implementation and supported by massive export promotion efforts and by improved management and recapitalization of enterprises in the private sector: (a) exports of manufacturing goods are projected to grow on average by about 4.9% in real terms during 1986-90, from 0% in 1985; (b) imports of goods are projected to grow on average by about 4.7% in real terms on average during 1986-90, from a drop of 3% in 1985; and (c) the current account

deficit of the balance of payments is projected to fall from an estimated US$2.2 billion in 1984 to an estimated US$2.1 billion in 1986 and turn into surplus of US$1.2 billion in 1990.

FINANCIAL SYSTEM

A. Analysis

13. The efficiency of the financial system will be a key element in the speed and effectiveness of the recovery in Argentina. Once the economy has reached capacity in the productive sectors, the availability of credit at realistic interest rates will be the key to stimulating investment in future productive capacity. The financial sector, having been severely battered over the past decade, is in a poor position to provide the type of efficient service that the economy is going to need. It is currently characterized by substantial overexpansion, poorly run banking institutions, almost inexisting supervision by the Banking Superintendency, and by intermediation spreads of as much as 4% real per month reflecting not only an overall scarcity of funds, but more importantly, substantial inefficiencies in the system itself. Even with more normal levels of money supply in the economy, it is estimated that financial institutions would need spreads of 1.5% to 2% per month to break even. In effect, the system has operated like an oligopoly, despite the large number of participant institutions, protecting the least efficient ones and guaranteeing large economic rents to the more efficient ones. Analysis of the sector also indicates that low productivity is not confined solely to small institutions and that a policy of encouraging mergers will not, in itself, solve the problem. Other factors working to increase interest rate spreads include the 2% surcharge used to finance the Institute of Social Services for Bank Employees (ISSBE), the CRM (a device to reallocate the burden of differential reserve requirements) and various mechanisms to direct credit.

14. The goal of the reform of the financial sector should be to eliminate distortions and allow the market to define the spreads between the deposit rate and the lending rate. The increased monetization of the economy will then be reflected in declining interest rates.

B. Policy Recommendations

15. While a return to more normal levels of money supply in relation to GDP will certainly help to create a more healthy financial sector, there are a number of specific policy measures that must be taken within the sector itself:

(a) restructuring of the sector by means of (i) increasing the minimum capitalization required for financial institutions; (ii) temporary fiscal measures to encourage consolidation; and (iii) a program aimed at public as well as private banks and at large as well as small;

(b) removal of the ISSBE surcharge and its coverage by alternate fiscal measures;

(c) removal of the CRM, recognizing that its allocative function has never worked efficiently;

(d) shifting the bulk of reserve requirements on sight deposits with a very low requirement, say 10%, on time deposits;

(e) elimination of credit subsidies.

(f) reduce controls to direct credit; and

(g) strengthen the supervisory role of the Banking Superintendency.

C. Potential Results

16. The above reforms should be sufficient for the market to function, lowering real intermediation spreads and allowing the development of an interest rate structure that would attract deposits while not discouraging investment in new plant and equipment. The restructuring of the banking system is bound to be gradual, however, and the economic and political costs of required adjustments may be high.

TAX ISSUES

A. Analysis

17. Argentina's basic tax structure is sound and appropriate for its level of development, including taxes on income, wealth, and value added. The revenue generated by the tax system, however, has been characterized in recent years by high volatility. Poor tax administration and widespread leakages through exemptions have led to a serious deterioration of government tax revenues. Total taxes collected are less than 20% of GDP. Income taxes amount to only 1.5% of GDP, and the value added tax (VAT) yields, in spite of the 18% rate, only 3.5% of GDP. Customs and excises are too high a share of revenues for a country of Argentina's level of development and create significant distortions both on the supply and on the demand side of the economy.

18. Policy objectives in the tax area should focus on increasing the yield from the existing structure through better administration of income, value added, and wealth taxes. There is strong evidence that tax administration has been hampered by poor information, frequent tax changes, repeated amnesties, and by penalty interest rates substantially below the taxpayer's cost of capital. Argentina's goal should be to raise tax revenue within the existing tax structure with emphasis on the elimination of tax exemptions and loopholes.

B. Policy Recommendations

19. Specific changes recommended include:

(a) taxes on foreign trade: to be significantly phased out for agricultural exports;

(b) property taxes: introduce a production-neutral federal land tax, including an accurate cadastre;

(c) tax administration: (i) unification of taxpayer identification for each separate tax collecting entity; (ii) phasing out of expensive "visit" system in favor of distribution of information on "cross compliance"; (iii) concentration of audit efforts on VAT; (iv) sharply increased penalties for evasion; (v) penalty interest for delinquency to be set significantly above taxpayers' cost of capital; and (v) elimination of amnesties;

(d) income taxes (corporate): to be left largely as is except to: (i) broaden tax base; and (ii) include profits on the sale of agricultural properties;

(e) wealth taxes: (i) to be extended (due to run-out in 1985) as is; and (ii) to eliminate deduction of 50% of assessed value of agricultural property;

(f) taxation on goods and services: (i) turnover tax to remain unchanged; and (ii) in VAT eliminate most of exemptions given for industrial incentives purposes; and

(g) excise tax: (i) not to be broadened; and (ii) focus on commodities where government has direct control over the collection (e.g., gasoline).

C. Potential Results

20. The overall target would be for tax revenues to gradually reach 25% of GDP by 1990, a level which would be adequate to allow for real increases in public services and an increasing contribution of government savings to investment.

II. IMPROVING THE EFFICIENCY OF THE PUBLIC SECTOR

21. A framework for reforming the public sector should include the medium-term role of the public sector in the productive areas; through restructuring and divesting public enterprises. Public sector's share in total investment should also gradually decrease. Public enterprises should not have preferential access to credit. Budgetary policy should be such that only transfers for equity take place and that operating losses of enterprises not be financed by either the Central Bank or the budget. Finally, enterprises should be managed as commercial entities, including policies over wages, product prices, recruitment and dismissals.

PUBLIC SECTOR INVESTMENT AND FINANCING

A. Analysis

22. Since 1977, public investment has declined by 60% in real terms. In recent years, the Government has encountered difficulties cutting current expenditure and has resorted to sharp cuts in investment. The cuts have been made haphazardly, and essential services have deteriorated. The critical areas where deterioration has reached a scale to constrain the expansion of trade are the following.

(a) Port services are not adequate for an expanded volume of grain exports. The bottlenecks are likely to become even more serious if exports continue to expand.

(b) Exploration and exploitation of hydrocarbon resources have fallen behind the country's estimated potential. As soon as the economy recovers, consumption will increase and the country may face the danger of becoming an importer of hydrocarbons.

(c) Roads feeding main transport corridors are either lacking or have deteriorated seriously. The agricultural export potential (especially fruits/vegetables) is not being fully exploited because of high transport costs/quality deterioration resulting from incomplete/bad feeder roads.

(d) The telecommunications network is inadequate to meet the needs of business and residential users. Waiting lines for telephone installation stretch to 5-7 years, raising operating costs significantly.

B. Policy Recommendations

23. Policy reforms are extremely difficult to achieve in this sector. Some of the proposals outlined below have been previously recommended, as far back as 25 years ago. Specific changes proposed include:

(a) rapid completion of dredging and the reconstruction of hinterland services at the Bahia Blanca port; and encouragement of private sector to build river ports;

(b) concentration of YPF's (the State Oil Company) resources on oil exploitation and liquid extraction, gas gathering and enhanced oil recovery projects; and accelerating the projects of oil and gas pipeline construction, particularly those for Formosa oil fields and for Lujan de Cuyo;

(c) increased emphasis on road reconstruction and maintenance and gravel surfacing on roads with more than a minimum (e.g., 100) average daily traffic; shifting railway transport operations to bulk freight with unit trains over a basic network of 16,000 km; emphasis on railway track renewal and bridge/culvert repairs; and

(d) encouragement of private sector participation in the provision of telephone services.

24. The public investment budget will continue to be tight in the foreseeable future. At the same time, average public tariffs for users have already reached--with the exception of water supply and electricity--a level above which Argentine producers' international competitiveness could be negatively affected. Therefore, priority investments should increasingly have to be financed from increasing productivity, revenue sharing and cuts on non-priority investments. These are highly desirable but difficult to achieve.

(i) productivity increases: (i) reduction of public employees through attrition; (ii) provision of adequate wage differentiation and production incentives; (iii) reinforcement of managerial accountability and introduction of cost accounting in public enterprises; (iv) cutting uneconomic production lines and transport losses; and (v) restructuring of some enterprises to expose them to competition;

(ii) revenue sharing: (i) elimination of earmarked funds for non-priority projects; (ii) allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources; and (iii) real increases in water and electricity tariff revenues;

(iii) actions on non-priority investments: (i) in the energy sector minimization of coal investments and postponement of major hydroelectricity projects; (ii) in road transport, reduction of investments in upgrading/capacity, and decreases in "strategic" roads with very low traffic and in new paving; (iii) in railway transport, elimination of new electrification schemes, and reduction of investments in passenger traffic; (iv) in maritime transport slowing down the expansion of the merchant fleet; and (v) in industry, cancellation of the expansion of the petrochemical production capacity in Bahia Blanca, of the new sheet steel rolling mill by SOMISA, and of the expansion of shipyards.

ENERGY

A. Analysis

25. Falling proven oil reserves and heavy reliance on petroleum as the primary energy source jeopardize Argentina's self-sufficiency in liquid fuels. Substantial new drilling is needed to maintain production in order to avoid imports. Proven and potential reserves of gas are almost twice as important as those of oil, but increased use of gas (including its possible export) is constrained by the limited transport infrastructure. Rationalization of oil and gas development requires more attractive and stable incentives for the private sector, clarification of the latter's role vis-a-vis the Government's, bringing absolute as well as relative prices of hydrocarbon products more in line with the economic cost of fuels, and strengthening public sector agencies in the energy sector, notably their financial condition and planning framework.

26. The Government's past efforts in the oil and gas sector focussed on exploration and production of oil to assure self-sufficiency and substitution of relatively abundant gas for liquid fuels. Energy conservation received little attention. The petroleum sector has the potential not only to assure the country self-sufficiency in oil but also to produce significant surpluses for export. At the same time, it has the potential to contribute significantly to reducing the overall fiscal deficit. It would be possible to continue to substitute gas for liquid fuels if a significant expansion of gas transmission infrastructure can be achieved during the next three to four years. Over the medium and longer term, Argentina's oil and gas reserve base could be expanded and important energy conservation efforts should be supported.

27. Policy objectives on oil and gas should focus on the following areas: (a) developing the infrastructure for oil and gas transport; (b) defining an adequate framework for an expanded private sector role; (c) rationalizing price structures and taxation; (d) financial and institutional restructuring of major public enterprises in the energy sector; and (e) launching of an energy conservation program.

B. Policy Recommendations

28. Specific changes recommended include:

(a) infrastructure: (i) government decision on the expansion of the gas transportation system (and corresponding gas gathering, treatment, and distribution through significant private sector (local and foreign) participation. Specifically, whether to expand the Central-West pipeline or to construct a new pipeline from Neuquen via Bahia Blanca to Buenos Aires; and (ii) solution of the COGASCO dispute would also be an integral part of this decision;

(b) private sector role: (i) encourage private sector participation by awarding new exploitation and exploration contracts to private firms which have the financial and managerial capabilities to supplement YPF's efforts in order to expand oil and gas reserves; and (ii) limit or eliminate convertibility risks (i.e., exports of products as guarantee for foreign currency obligations) and facilitate access to domestic credit (i.e., "apex" financing arrangements to support private sector borrowing needs);

(c) public enterprises: strengthen financially YPF and gas del Estado and reorganize their accounting and control systems;

(d) pricing and taxation: (i) adjust the price of natural gas, taking its long-run opportunity cost as a guide; (ii) adjust the price of diesel as a function of the regular gasoline energy equivalent; (iii) review the level and structure of prices of other energy products; (iv) review relationship with energy conservation incentives; and (v) review the costs and benefits of the existing structure of taxation of the energy sector with a view to increasing efficiency; and

(e) conservation: (i) design and implement an energy conservation program including pricing and taxation aspects; and (ii) study of the energy efficiency of the power sector and of the possibilities for end-user conversion and savings.

C. Potential Results

29. Official reserve estimates assume that only 19% of the oil in the ground may be recovered. This appears low by international standards. It may well be that a recovery rate of around 25% or more is possible. This would increase proven reserves fron around 370 million cubic meters to over 600 million cubic meters of oil and would allow exports of crude oil or petroleum products of around 70,000 - 100,000 barrels per day amounting to US$0.6 - 1.0 billion (at US$24 per barrel). New resource discoveries combined with energy conservation efforts should allow Argentina to maintain self-sufficiency in energy use for the next two or three decades.

30. Over the next five years, annual investments of US$1 billion or more would be required in the petroleum sector and around US$500 million in gas transmission and distribution. Under the foreseeable constraints on government investment funds, neither YPF nor GdE will be able to finance such programs on their own, nor would they have the capacity to implement them. However, by involving the private sector and by using new financing instruments such as limited recourse financing and funds from international development banks, implementation of such investment programs would be feasible even in the present environment of tight public investment funds. The efficiency of these undertakings could be significantly improved by restructuring YPF and by deregulating the present pricing policy framework in the petroleum sector. YPF's investment program which was already reduced from a high of US$1.8 billion in 1980 to about US$900-1000 million (including dry wells) in 1985 could be further reduced to around US$600 million by the late 1980s. Offering areas for exploration to private sector firms could reduce investment needs for YPF by US$100-200 million per annum. New exploration contracts could decrease YPF's investment requirements for production and provide the capacity to achieve the export targets mentioned above before the end of the decade. US$200-300 million of investments per year appear to be an achievable target for private sector production activities.

TRANSPORT SECTOR

A. Analysis

31. Public enterprises in the transport sector are an important drain on the Treasury's financial resources on account of their operating deficits and their investment programs. At the same time, their efficiency has an important bearing on the profitability of export-oriented domestic production and on reducing the cost of bringing imports into the country.

32. The sector is beset by bottlenecks and idle capacity which go side-by-side as a result of poor resource allocation and disinvestment, serious deterioration of infrastructure, poor maintenance, and obsolescence of rolling stock and fleet. There is little intermodal coordination; responsibilities of transport agencies are unclear, and the roles of the public and private sectors remain largely undetermined. Funds are earmarked for specific modes of transport or institutions without taking into account demand and rate of return criteria. Planning systems, staffing and information are inadequate. The Ministry of Public Works and Services lacks systematic information on project preparation and monitoring. There has been a major loss of experienced and trained staff while underemployment of lower level personnel has increased.

33. Policy objectives in transportation should focus on: (i) measures necessary to allow public enterprises to operate like commercial entities, including increased prices for public services, and adequate cost recovery; and (ii) policies to improve sector planning, investment follow-up, reduce public sector investment requirements through increased private sector participation, and deregulate and privatize transport sector activities.

B. Policy Recommendations

34. Policy reforms are extremely difficult to achieve in this sector. Some of the proposals outlined below have been previously recommended as far back as 25 years ago.

(a) increased prices of public sector services to ensure adequate cost recovery in, ports dredging, and railroads, and the introduction of road user charges;

(b) improvement of efficiency of operation of the railways. Since this is an area where all previous efforts have failed, it would represent a major task. It should include: (i) reduction of manpower (currently 108,000), closure of uneconomic lines, generation of operation/line-specific economic information to allow the assessment of the merits of expenditure programs; (ii) an overall reduction of the 1986-90 investment expenditures by 60%; and shifts in investment priorities: from passenger traffic to bulk freight (using unit trains over a basic network of 16,000 km); from the expansion of rolling stock (limiting purchases to replacement needs) and new electrification schemes to track renewal and bridge and culvert repairs; and to investments to control of operations, including the coordination of broad-gauge lines;

(c) improvement of efficiency of operation of maritime and air transport. This should include: (i) reduction in total investment expenditure; introduction of a toll system to cover major reequipment costs; efficiency improvements of import dredging operations; and elimination of legal obligations to buy from domestic shipyards; and (ii) shifts in investment priorities from the expansion of the merchant fleet to dredging and port support services and elevators, and from a possible air fleet standardization investment to the improvement of air traffic control systems;

(d) strengthening of MOSP planning and follow-up including the restoration of national transport planning as part of the global public investment planning mechanism, and the elimination of earmarked funds. In most road transport, priorities need to be shifted (i) from upgrading/capacity increases to reconstruction (current investment projects allocate 73% and 26%, respectively, to the former and the latter); (ii) from projects that are not likely to yield acceptable rates of return (due to expected traffic levels below minimum), that are allocated 52% of total investment expenditure, to higher traffic corridors; and (iii) from new paving projects with expected average daily traffic (ADT) of less than 100 to gravel surface projects with higher ADT;

(e) initiation of institutional reforms such as consolidation of port agencies and urban rail authority, and agreement on studies to implement action programs in the sector; and

(f) deregulation and privatization in areas of offshore storage/shipping facilities, containerization, tugboat service, and highway maintenance.

C. Potential Results

35. Action on the above areas would result in a more efficient and less costly transport operation in support of Argentina's export promotion efforts. At the same time, the negative effects on the overall public sector deficit will be significantly reduced.

RESTRUCTURING AND PRIVATIZATION

A. Analysis

36. Restructuring and privatization of public sector industrial enterprises provide a further means to help reduce the Government's financial burden and public sector deficits and to increase industrial efficiency, competitiveness and exports. These are important areas of policy consideration because future growth possibilities of the economy may hinge critically on the ability of the Government to keep down public sector deficits, which otherwise could lead to uncontrollable upward pressures on inflation, interest rates and/or taxes.

37. Policy objectives in restructuring and privatization should focus on: (a) restructuring of public sector enterprises which often have large potential for cost reductions or which, through their linkages, could have a significant impact on the efficiency and competitiveness of other parts of the industrial sector as well as the rest of the economy; and (b) privatization of select state-owned enterprises.

B. Policy Recommendations

38. Specific actions recommended include:

(a) technical, financial and organization/management restructuring of selected public enterprises or subsectors to improve the efficiency and competitiveness of basic industries. The most significant benefits from restructuring can be expected in steel (mainly SOMISA) and telecommunications (ENTEL). Systematic restructuring/rationalization should focus on improvements in: (i) organizational structures and management and administrative processes, including the degree of the enterprises' autonomy and the nature of their relationship with the Central Government; (ii) balancing and/or modernization of existing production lines; (iii) production management techniques (e.g., inventory and other working capital management, appropriate balance between production capacity and size and composition of work force; (iv) financing; and (v) pricing/cost recovery techniques;

(b) mounting a comprehensive program for privatizing public enterprises especially in the productive sectors (e.g., petrochemicals) which should include: (i) the identification of potential local and foreign private sector investors who would be interested in the purchase of state-owned assets; and (ii) the determination of vehicle of transfer of assets to private investors, e.g., stock market, international competitive bidding, etc.

C. Potential Results

39. Benefits of restructuring/privatization programs are likely to be significant for other productive subsectors through cost reductions and efficiency components, as well as through linkage and potential impacts on competitiveness. In the near term, the efforts toward privatization could

help reduce the public sector deficit and support the Government's stabilization objectives. In the longer term, through better exploitation of the benefits of private initiative and entrepreneurship, they could also lead to significant efficiency improvements in many segments of the economy, help stimulate direct foreign investment, and facilitate export development.

Table 1: ARGENTINA - Summary of Key Macroeconomic Aggregates, 1978-1985

(percentages)

	1978	1979	1980	1981	1982	1983	1984	Estimated 1985
GDP Growth Rate	-3.4	6.7	0.7	-6.2	-5.2	3.1	2.0	-3.0
Debt/Export Ratio 1/	1.62	2.0	2.5	3.1	4.6	4.8	4.7	4.7
Interest/Export Ratio 2/	1.69	14.6	20.4	33.0	51.6	56.8	55.8	50.6
Total Debt/GDP 3/	23	28	31	40	63	61	62	69
Interest Payments/GDP 4/	2.4	2.1	2.5	4.3	7.0	7.2	7.0	7.0
Debt Service Ratio 5/	38	24	31	43	65	71	64	61
Terms of Trade	78	83	94	107	92	88	93	89
Import Growth Rate 6/	-4.9	45.4	45.4	0.4	-41.2	-2.4	1.5	-5.3
Export Growth Rate	12.2	-3.0	-4.9	5.9	-2.4	11.5	-1.2	11.6
Current Account Balance	1,833	-537	-4,767	-4,714	-2,357	-2,461	-2,492	-1,280

1/ Total debt including short-term/exports goods and NFS; absolute ratio.
2/ Total interest payments to exports goods and NFS.
3/ Total debt including short-term/GDP.
4/ Total interest payments/GDP.
5/ Total interest and amortization on MLT divided by exports of goods and non factor services.
6/ Real growth rates in 1970 prices.

Table 2.A: ARGENTINA - Projections of Key Variables, 1985-1994, Base Case Scenario
(percentages and 1985 U. S. Dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP growth rate	-3.0	2.7	3.5	3.3	3.3	3.2	3.3	3.3	3.4	3.4
GDP/capita	2,049	2,066	2,101	2,131	2,163	2,194	2,225	2,257	2,292	2,328
Debt/Exports	4.8	5.0	5.0	4.5	4.1	3.7	3.3	3.3	2.8	2.5
Total Debt Outstanding and Disbursed (billions)	48.6	50.1	51.6	52.4	53.2	53.2	53.6	52.6	51.0	48.7
Debt/GDP)	69	69	69	68	66	64	62	59	55	50
Interest Payments/GDP	7	6	6	5	5	4	4	4	3	3
Debt Service ratio (exclud. short term)	61	67	50	44	43	42	43	39	39	38
Public Investment a/	2,451	2,426	2,523	2,624	2,729	2,839	2,952	3,070	3,193	3,321
Public Investment/GDP	4.9	4.8	4.8	4.8	4.8	4.9	4.9	5.0	5.0	5.0
Private Investment a/	3,827	4,264	4,596	4,964	5,356	5,774	6,207	6,672	7,173	7,711
Private Investment/GDP	7.7	8.4	8.7	9.1	9.5	9.9	10.3	10.8	11.2	11.6
Public Savings/GDP	6.9	7.9	8.2	8.8	9.0	9.3	9.6	10.0	10.2	10.5
Private Savings/GDP	12.2	10.6	11.1	10.9	11.1	11.1	11.1	11.1	11.2	11.4
Exports Growth Rate	11.6	-3.0	6.7	3.0	3.4	2.4	3.0	3.0	3.5	3.6
Exports/GDP	15.1	14.2	14.7	14.6	14.6	14.5	14.5	14.4	14.5	14.5
Imports Growth Rate	-5.3	4.8	3.8	3.7	3.7	3.7	4.0	4.0	4.1	4.1
Imports/GDP	8.6	8.8	8.9	8.9	8.9	9.0	9.0	9.1	9.1	9.2
Consumption/Capita Growth Rate	-5.2	1.5	0.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0
GNP Growth Rate	-2.8	3.3	4.0	4.1	3.6	3.7	3.8	3.6	3.7	3.8
GNP/Capita	1,898	1,926	1,967	2,012	2,048	2,086	2,128	2,165	2,206	2,249

a/ In thousand billions of 1984 pesos.

Notes:
1. Debt includes public and publicly guaranteed, private non-guaranteed and short term debt.
2. Exports and imports include that of goods and non-factor services.

Table 2.B: ARGENTINA - Projections of Key Variables, 1985-1994, High Case Scenario

(percentages and 1985 US dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Real r (LS)	5.5	5.0	4.5	4.0	3.5	3.5 →		3.5 (30–35)		
GDP growth rate	-3.0	2.6	4.3	4.6	4.8	4.4	4.3	4.3	4.4	4.4
GDP/capita	2,049	2,066	2,117	2,176	2,241	2,297	2,355	2,412	2,474	2,537
Debt/Export	5.1	4.8	4.4	3.9	3.4	2.9	2.8	2.6	2.4	2.2
Total Debt Outstanding and Disbursed	48.6	50.1	51.9	52.5	52.6	53.2	53.9	54.3	54.8	55.2
Debt/GDP	69	65	60	54	48	42	38	34	29	25
Interest Payments/GDP	7	6	6	5	5	4	4	3	3	3
Debt Service Ratio (exclud. short term)	61	67	49	41	39	40	45	43	48	36
~~Public Investment~~ a/	2,451	2,426	2,596	2,765	2,931	3,092	3,246	3,409	3,579	3,758
Public Investment/GDP	4.9	4.8	4.9	5.0	5.0	5.1	5.1	5.1	5.2	5.2
~~Private Investment~~ a/	3,827	4,264	4,690	5,253	5,830	6,413	6,991	7,550	8,154	8,806
Private Investment/GDP	7.7	8.4	8.8	9.4	10.0	10.5	11.0	11.4	11.8	12.2
Public Savings/GDP	6.9	7.9	9.2	9.8	10.0	10.3	10.6	11.0	11.2	11.5
Private Savings/GDP	12.2	10.6	10.1	10.3	10.9	11.0	11.1	11.0	11.2	11.3
Exports Growth Rate	11.6	-3.0	8.6	6.3	6.7	4.1	4.6	4.3	5.2	5.1
Exports/GDP	15.1	14.2	14.8	15.0	15.3	15.3	15.3	15.3	15.4	15.5
Imports Growth Rate	-5.3	4.8	9.3	5.8	6.2	6.0	5.9	5.6	5.5	5.5
Imports/GDP	8.6	8.8	9.2	9.3	9.5	9.6	9.7	9.9	10.0	10.1
Consumption/Capita Growth Rate	-5.2	1.5	1.5	1.75	2.0	2.0	2.0	2.0	2.0	2.0
GNP Growth Rate	-2.8	3.3	4.9	5.6	5.2	4.9	5.0	4.7	4.8	4.8
GNP/Capita	1898	1925	1985	2059	2127	2193	2261	2324	2393	2464

a/ In thousand bullions of 1984 pesos.

Notes:

1. Debt includes public and publicly guaranteed, private non-guaranteed and short term debt.
2. Exports and imports include that of goods and non-factor services.

Table 3.A.1: ARGENTINA - Projections of Commitments, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	240	630	500	500	500	500	2,870
IDB (or other multilateral)	400	400	300	200	200	200	1,700
Bilateral Official Exp. Credit							
Suppliers' Credits	1,100	1,200	900	800	800	700	5,500
Commercial Banks	2,992	1,865	1,334	727	929	209	8056
TOTAL	4,732	4,165	3,034	2,227	2,229	1,409	18,056

Table 3.A.2: ARGENTINA - Projections of Disbursements, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	146	478	462	470	425	400	2,381
IBD	236	470	157	189	192	196	1,440
Bilateral/Official Exp. Credit							
Suppliers' Credits	695	826	375	375	325	275	2,871
Commercial Banks	2,992	1,865	1,334	727	929	209	8,056
TOTAL	4,069	3,639	2,328	1,761	1,871	1,080	14,748

Table 3.A.3: ARGENTINA - Projections of Repayments, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	116	149	161	159	178	198	961
IDB	76	100	35	50	68	118	447
Bilateral							
Official Exp. Credit	143	249	168	222	388	413	1,583
Suppliers' Credits							
Commercial Banks	765	982	—	—	—	466	2,213
TOTAL (including IMF)	1100	1480	364	431	634	1195	5204

Table 3.A.4: ARGENTINA - Projections of Net External Flows, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	30	329	301	311	247	202	1,420
IDB	160	370	122	139	124	78	993
IMF	702	400	-150	0	-300	-300	652
Bilateral							
Official Exp. Credit	552	577	207	153	-63	-138	1,288
Suppliers' Credits							
Commercial Banks	2,227	883	1,334	727	929	-257	5,843
Direct Foreign Investment (net)	214	246	285	330	384	447	1,906
TOTAL (incl. IMF and DFI)	3,885	2,805	2,399	1,660	1,321	32	12,102

Table 3.B.1: ARGENTINA - Projections of Commitments, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	240	630	800	900	900	900	4,370
IDB	400	400	500	500	500	500	2,800
Bilateral) Official Exp. Credit) Suppliers' Credits)	1,100	1,200	700	500	400	400	4,300
Commercial Banks	3,423	1,859	1,293	0	0	0	6,575
TOTAL	5,163	4,089	3,293	1,900	1,800	1,800	18,045

Table 3.B.2: ARGENTINA - Projections of Disbursements, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	146	478	600	670	670	600	3,164
IDB	236	470	157	189	192	196	1,440
Bilateral) Official Exp. Credit) Suppliers' Credits)	695	826	375	325	275	247	2,743
Commercial Banks	2,992	1,865	1,293	432	303	0	6,885
TOTAL	4,069	3,639	2,425	1,616	1,440	1,043	14,232

Table 3.B.3: ARGENTINA - Projections of Repayments, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	116	149	161	159	178	198	961
IDB	76	100	35	50	68	118	447
Bilateral) Official Exp. Credit) Suppliers' Credits)	143	249	168	222	388	413	1,583
Commercial Banks	765	982	0	0	0	805	2,552
TOTAL (including IMF)	1,100	1,480	364	431	634	1,534	5,543

Table 3.B.4: ARGENTINA - Projections of Net External Flows, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	30	329	439	511	492	402	2,203
IDB	160	370	122	139	124	78	993
IMF	702	400	-150	0	-350	-300	-602
Bilateral) Official Exp. Credit) Suppliers' Credits)	552	577	207	103	-113	-166	1,160
Commercial Banks	2,207	883	1,293	432	303	-805	4,333
Direct Foreign Investment (net)	269	214	246	285	330	384	1,728
TOTAL (including IMF and DFI)	3,940	2,773	2,457	1,470	1,136	-107	11,019

Table 4.1: ARGENTINA - Projections of Debt Outstanding and Disbursed, 1985-90: Base Case

(in millions of US dollars, end of period)

	1985	1986	1987	1988	1989	1990	Change 1984/1990
World Bank	579	985	1,286	1,597	1,844	2,046	1,420
IDB	1,104	1,465	1,587	1,726	1,850	1,928	993
IMF	1,800	2,200	2,350	2,350	2050	1750	652
Bilateral							
Official Exp. Credit	5,535	6,112	6,319	6,472	6,409	6,271	1,288
Suppliers' Credits							
Commercial Banks	35,860	37,174	38,391	39,118	40,047	39,790	5,843
Total Medium & Long Term DOD	44,878	47,936	49,933	51,263	52,200	51,785	10,196
Short Term Debt	5,005	4,500	4,000	3,500	3,004	3,175	-3,395
TOTAL	49,883	52,436	53,933	54,763	55,204	54,960	6,801

Table 4.2: ARGENTINA - Projections of Debt Outstanding and Disbursed by Source, 1985-90: High Case

(in millions of US dollars, end of period)

	1985	1986	1987	1988	1989	1990	Change 1984/1990
World Bank	579	985	1,424	1,935	2,427	2,829	2,203
IDB	1,104	1,465	1,587	1,726	1,850	1,928	993
IMF	1,800	2,200	2,310	2,310	2,050	1,750	652
Bilateral							
Official Exp. Credit) Suppliers' Credits)	5,535	6,112	6,319	6,422	6,309	6,143	1,160
Commercial Banks	35,860	37,174	38,350	38,782	39,085	38,280	4,333
Total Medium & Long Term DOD	44,878	47,936	50,030	51,175	51,721	50,930	9,341
Short Term Debt	5,005	4,500	4,000	3,500	3,165	3,383	-3,187
TOTAL	49,883	52,436	54,030	54,675	54,886	54,313	6,154

COUNTRY: ARGENTINA
FY86-FY90 PROPOSED LENDING PROGRAM - PROJECT DETAIL
NOVEMBER 27, 1985

High Case

MANAGING UNIT	PROJECT / STATUS		PLAN/ACT. APPRAISAL DEPARTURE	US$ Million BANK
FY86				
LC2PB	PA041-TAI-B	L	11/85	20.0
LCPWS	PA025-Water Supply-B	L	02/85	60.0
LCPAC	PA036-Agric. Sector-C	L	05/85	350.0
LCPEN	PA042-Power Eng.-B	M	11/85	10.0
	FY86 Totals: Lending Amount			440.0
	Number of Projects			3
FY87				
LCPT1	PA024-Bahia Blanca I-C	S	12/84	40.0
LC2PB	PA050-Trade Policy-C	L	06/86	350.0
EGYD2	PA047-Refinery Supp Ln-S	M	11/85	110.0
LCPI2	PA046-Sm. & Me. Ind. B	L	06/86	100.0
EGYD2	PAO -Oil & Gas Private D	L	06/86	100.0
	FY87 Totals: Lending			700.0
	Number of Projects			4
FY88				
LCPI2	PAO -Financial Sector D	S	06/86	350.0
LCPEN	PA051-Power Distrib. D	L	09/86	150.0
LCPI2	PA046-Export Promotion C	S	06/86	200.0
EGYD2	PAO-Gas Pipeline D	L	09/86	200.0
	FY88 Totals: Lending Amount			900.0
	Number of Projects			4
FY89				
LCPI2	PA027-Industrial Cr.III-D	S	03/87	150.0
LCPI2	PAO-Financial Sector II D	L	07/87	350.0
EGYD2	PA028-Oil & Gas Infrast.D	S	06/87	100.0
LCPI2	PAO -Trade Policy II D	L	06/87	350.0
	FY89 Totals: Lending Amount			950.0
	Number of Projects			4
FY90				
INDD3	PAO -SOMISA Restruct. -D	S	06/87	50.0
LCPEN	PA051-SEGBA V C	S	06/88	150.0
LCPWS	PAO Water Supply D	L	06/89	80.0
LCPI2	PA053-Export Promot. II-D	S	06/88	100.0
LCPURB	PAO Housing D	L	06/89	75.0
LCPURB	PAO Market Town Impr.-D	L	05/88	75.0
LCPTR	PAO Transp. Sector II-D	L	06/89	350.0
	FY90 Totals: Lending Amount			880.0
	Number of Projects			7
	TOTAL LENDING AMOUNT			3,870.0
	NUMBER OF PROJECTS			22

Reserve Projects:

FY87				
LCPAC	PAO -Agric. Sector II C	L	09/86	350.0
FY88				
LCPTR	PAO -Bahia Blanca II C	L	09/86	160.0
LCPEN	PAO -Yacyreta C	L	09/86	200.0
FY89				
LCPTR	PAO -Transport Sect. I-D	S	06/86	350.0
LCPI2	PAO -Financial Restruc.D	L	06/87	100.0
FY90				
INDD4	PA055-ENTEL Restruct. -D	S	06/88	150.0

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: 12/26/85

NAME	ROOM NO.
Mr. A. Choksi	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

The attached was delivered to Mr. Stern on Tuesday morning, December 24th.

FROM: Vinod Dubey	ROOM NO.:	EXTENSION: 60061

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

A.C.
→ BR.

DATE: December 20, 1985

TO: Mr. E. Stern, SVPOP

FROM: S. Shahid Husain, OPSVP

SUBJECT: Argentina: Medium-Term Adjustment Program

1. Attached for your review, is the revised draft of the medium-term economic adjustment program for Argentina. It reflects the discussion of the OVPs' meeting and has been cleared by the region. If you agree, I will begin discussions with the Fund after I return.

2. The current status of the other adjustment programs is as follows:

Country	Draft	Due Date
Morocco	Final 1/	Jan. 8
Colombia	First	Completed Dec. 10
	OVP Discussion Draft	Jan. 31 (date to be confirmed) 2/
Chile	First 3/	Jan. 2
Brazil	First	Jan. 2
Mexico	First	Jan. 2
Nigeria	[Delayed, see para. 4]	
Yugoslavia	First	Jan. 31

3. For each country, the first drafts of the adjustment programs is reviewed by members of Finance, PBD, ERS and CPD. Incorporation of the relevant comments leads to the OVP discussion draft.

4. The completion of the Nigeria adjustment program will be delayed until early next year because of imminent changes in the government's budget policy. Yugoslavia has recently volunteered to prepare an adjustment program by end-January.

1/ Final draft refers to drafts that reflect the OVPs' discussion.

2/ Because of travel and holiday plans of regional staff, the OVP discussion draft will be delayed to end of January.

3/ The expected date of OVP discussion drafts for Chile, Brazil and Mexico will be around January 15.

P-1867

5. If you find the current format for Argentina suitable, we will also follow it for the other adjustment programs.

6. The overview paper being prepared by CPD on Adjustment Programs in Heavily Indebted Countries, will draw on the individual country adjustment programs and will focus on adjustment policies in these countries and on the role the Bank can play in assisting them. This paper, which is being prepared for internal management discussion, is due to you by the end of January. It is currently under preparation and parts of it will form inputs in the Development Committee paper being coordinated by ERS.

7. I have spoken to David Finch and, after your approval, we shall give each paper to him for discussion with the Fund. The first one will be Argentina.

ht

December 22, 1985

ARGENTINA: BAKER INITIATIVE COUNTRY STUDY

I. Initial Conditions

Economic Performance

1. Argentina's economy has been adversely affected by a poor political milieu and inappropriate economic management since the early 1950s. Over the last decade, abrupt shifts and inconsistencies in policies weakened Argentina's productive capacity and exacerbated structural imbalances. Economic mismanagement led to an increase of the country's external debt, which, as a share of GDP, has multiplied almost seven-fold (from 10% to 67%) during the last decade. Interest payments on the external debt now absorb about 40% of gross domestic savings compared to less than 5% in the early 1970s. While the external debt increased, domestic production declined. In 1985, real GDP per capita was 13% below its 1974 level. Investment declined to 13% of GDP, from an average of 21% during the early seventies.

2. The productive sectors, particularly manufacturing, are beset by thorny structural and financial problems. More than 40% of capacity in the construction industry now stands idle. Significant underutilization of capacity also exists in many manufacturing industries; and most firms also lack sufficient working capital. Financial intermediation is costly and inefficient, interest rates are high in real terms, and oversized banking institutions are suffering severe difficulties. Argentina's self-sufficiency in oil has deteriorated as the ratio of oil reserves to annual output has declined. Proven reserves of gas have increased, but the processing and transport infrastructure to exploit them is deficient.

3. Unfavorable changes in the external environment during 1979-82 further aggravated domestic problems. Argentina suffered external shocks equivalent to 4% of GNP owing primarily to deteriorating terms of trade and high interest rates. This situation was compounded by a deterioration in export competitiveness and a rapid increase in imports as the peso became increasingly overvalued. The policy response was primarily to resort to additional external borrowings. This was accompanied by some contraction of economic activity. The unfavorable external shocks and the poor policy response were further compounded by the South Atlantic war and subsequent political instability.

Stabilization Efforts

4. A democratic Government took office in 1983. The Alfonsin administration confronted a difficult situation: the economy was in poor shape following the 1982 military adventure, inflation was running at close to 20% per month, the fiscal deficit was about 16% of GDP, and the external debt exceeded US$45 billion. Nevertheless, most social groups greeted the new Government with strong expectations for an improvement in their living standards. The Government first used a gradualist approach to tackle Argentina's problems, but with little success. There was a modest gain in real output led by real wage increases but, in order to finance a seemingly

chronic public sector deficit, the Government was obliged to resort to domestic financing, which produced a steady increase in inflation. The Government entered into a stand-by agreement with the Fund but was unable to meet the agreed targets. As the economy came perilously close to complete chaos, the Government changed gears and moved to shock treatment in mid-June 1985 with the Plan Austral and then reached agreement with the Fund on revised targets.

5. The Plan's main features were: (a) introduction of a temporary wage-price freeze to be supervised through spot-checks. However, before that a number of critical prices were adjusted. These included various public sector prices and an 18% devaluation; (b) a drastic cut in the overall public sector cash deficit, with the purpose of reducing it from 12.5% of GDP in the first half of 1985 to 2.5% in the second half of 1985. This was to be accomplished by increasing tax revenues, reducing real wages, and from falling interest payments resulting from lower inflation. The Government committed itself not to resort to Central Bank credit and to finance the deficit through capital inflows; and (c) a monetary reform introduced a new currency, the Austral, pegged to the U.S. dollar at a fixed rate.

6. The initial results have been impressive: monthly inflation has fallen from about 30% in May to 6% in June and about 2% per month on average during July-November; the overall public sector cash deficit has been cut down to slightly above 3% of GDP in the second half of 1985 without Government recourse to Central Bank credit; the deficit of the current account of the balance of payments has been reduced from 3.5% of GDP in 1984 to an estimated 2% of GDP in 1985. However, the stabilization program is encountering difficulties. First, the Government has been unsuccessful in containing the spending of some public enterprises and provincial governments. Unless additional measures are taken, the public sector deficit will exceed the Fund targets. Second, interest rates, although lower, now stand at 3% per month and discourage private investment. Third, the deficit in the current account of the balance of payments is expected to widen again in 1986, primarily because of continued deteriorating terms of trade and recent floods which have hampered agricultural production.

II. Objectives of the Medium-Term Program

7. In the design of a program for the medium-term recovery and development of the economy, it is important to recognize that the continuation of the Plan Austral is a necessary precondition for any program. Thus, even a base case scenario will require a continuing series of policy steps building upon and strengthening the program initiated in mid-1985. In laying out the scenarios of the medium-term program, three objectives have been established. First, recovery of Argentina's growth performance to the traditional 4-1/2%. Second, that a modest but steady improvement in real per capita consumption is a necessity for the social and political maintenance of the consensus behind any economic program. Third, that the ratio of debt to exports must be brought down to levels where the normal role of foreign capital in the Argentine economy can be reestablished.

8. Real per capita consumption has been declining for some time and in 1985 was lower than any time in the past 15 years. With interest payments on foreign debt currently absorbing almost 40% of savings and 7% of

GDP, it will be difficult to find much scope for improvements in real consumption. Nevertheless, the base case scenario explores the costs of providing a steady but modest improvement of 1% per year within a 3% real growth rate, while the high case explores the possibilities of accelerating this to 2% per year within the next decade in the context of a 4-1/2% real growth rate. On the external side, the objective is to reduce the burden of debt from its current high ratio of 5 times exports to more manageable, but still high levels of roughly 3 times exports by 1990, with the further objective of approaching ratios significantly below this during the following decade. Finally, it should be emphasized that the magnitude of the difficulties that the economy is currently experiencing is such that the differences between the base case--maintenance of the Plan Austral--and the high case--maximum effort--are fairly small in terms of results until 1989-90.

III. Implications of the Objectives of the Medium-Term Program

9. In assessing the implications of the objectives of the medium-term program, two key structural characteristics of the economy must be explicitly recognized. First, the economy is relatively mature with only small increases in population and labor force over the past half century. Thus, it would be unrealistic to expect growth rates of GDP to exceed 5% over a sustained period, even under conditions of maximum policy efforts. The second factor is the immense size of the external debt, equivalent to two-thirds of GDP and five times the size of exports. Even under the Plan Austral the economy does not generate enough surplus on the balance of payments to cover the interest on its debt. Thus, any program, even under the best of policy conditions, will require net lending to Argentina (either as fresh money or as capitalization of interest) for at least the next 3-4 years.

10. It is also important to point out that in our judgement it is necessary that the Plan Austral, in itself a bold and significant policy effort, be maintained, except for the wage price freeze, which should be phased out during 1986. Thus, we have taken this as our base case rather than setting forth the very dismal scenario that would emerge if we were to extrapolate the performance of the 1980-84 period, which would involve a stagnation in real growth, a continued decline in real per capita consumption, a highly protected and inefficient domestic economy, continued high debt to export ratios, and, in all likelihood, continued political instability. Thus, there is perhaps a less striking difference between our base and high cases than in other countries where similar analyses have been made.

11. Investment in Argentina has in recent years been an extremely low share (13%) of GDP and has been characterized by inefficiency with high ICORs. The program for the future does not call for massive new investments across the board, but rather selective investment in key areas, both public and private, with a focus on increased efficiency. Thus, it is projected that in the base case investment might productively be increased to about 15% of GDP by 1990 and about 17% by 1995 with private sector investment (currently 60% of the total) increasing about twice as fast as

public. In the high case, the ratios to GDP are only slightly higher (16% and 18%) but the ICORs are significantly lower as policy reforms, for example in the energy sector, are implemented allowing a significantly more efficient use of capital stock.

12. Roughly 40% of domestic savings is now being used to pay interest on external debt. Even under the best of policies it is not likely that this can be reduced to less than 20% before 1990. Saving itself, under either scenario, should show a modest improvement in its share of GDP in response to measures to reduce the public sector deficit and encourage private sector savings. The latter could be supported by the financial sector reform as well as by the improved investment climate generated by the policy package.

13. The exchange rate established in the June 1985 measures represented a more than competitive parity for the Austral. While there has been a modest domestic inflation since that time, the currency has not, in the opinion of the IMF, yet moved to a non-competitive position. It is expected, however, that during the period covered by our projection, the authorities will take the required policy measures, including--if necessary--periodic adjustments of the exchange rate in order to maintain the approximate competitiveness of the currency that existed during the latter half of 1985.

14. The key to Argentina's recovery and to the reduction of the heavy debt burden is the performance in the export sector. This is made all the more difficult by the relatively small degree of openness of the economy; exports are currently only 14% of GDP. In addition, the current weak position of the commodities that make up most of Argentina's exports does not augur well for rapid improvements in earnings in the short-run, even with maximum productive efforts by the country itself. Given that beef, wheat, soybeans, and sorghum are key commodities, it is unlikely that after 1985-86 improvement in production there will be more than 2-3% long-run real growth in exports. In the high case, full implementation of our policy recommendations in agriculture, trade, and more importantly in the energy sector, could result in real growth of exports in the 5% range.

15. On the import side the projections imply different assumptions on opening up the economy and, thus, on the share of GDP, given a competitive exchange rate and the phasing out of import restrictions. Under the base case, because of the necessity to have a modest improvement in per capita consumption, total external debt rises until 1992; in the high case this peak takes place until 1990, when the country begins to pay its debt. In the high case, the projection also assumes that there will need to be a significant opening up of the economy, and in particular, an acceleration of the value of capital goods imports, reflecting a capital deepening.

16. External debt, including short term, is currently just under US$50 billion. The debt service ratio, including short-term interest payments, is currently over 100% of exports.Not only does this debt present a serious impediment to the resumption of normal international financial relations for Argentina, but it also represents a heavy burden on domestic resource mobilization. At the present time, the interest payments on all of Argentina's debt are over US$5 billion, while the resource surplus on

the trade account is only slightly above US$3 billion. Thus, not only must exports grow, but efforts need to be made to reduce the size of the debt in relation to the economy. The implication of the current situation is that as there is an insufficient resource surplus to pay interest on the debt at least for the next two to three years, Argentina will have to arrange for lending to cover this requirement. Reschedulings, whether officially or de facto, will be required throughout the rest of the 1980s with the possibility of some potential for repayment of commercial bank lending during the 1990s.

17. The projections are based on the assumption that all debt to commercial banks as of the end of 1985 is serviced on interest with amortization being fully rolled over, and all other debt is fully serviced including all new debt from commercial banks. When the projections reach the point that all such payments can be made without fresh borrowing, the surplus is assumed to accumulate in reserves. At that point four choices will be available to the Argentine authorities by 1992 in the base case and by 1990 in the high case to: (i) repay principal on pre-1986 commercial bank borrowing; (ii) increase imports with a view to accelerating growth; (iii) increase imports so as to improve consumption levels; and (iv) accumulate foreign exchange reserves and earn interest on them. There is no clear-cut case for preferring any one of these alternatives. It is quite probable that increased investment in the Argentine economy, beyond the point where growth is in the 4-1/2% range, would not increase growth further, but rather lead only to increased inefficiency in the use of capital. Repaying the principal of the pre-1986 commercial bank debt is certainly possible, but would only be desirable if it would enhance Argentina's creditworthiness. Increasing reserves is not an end in itself, it simply increases the resources available to be spent and the temptation to spend them on large projects. If higher consumption levels than those projected in the above analysis are politically necessary, then the external resource requirements to effect full recovery will be higher. Finally, the authorities could certainly use the resources to increase consumption even earlier than projected, which while certainly attractive, could lead to increased inflationary pressures on the non-tradeable sectors of the economy. Clearly, the authorities, when the time comes, will utilize a mix of the four alternatives; the point is that this should be done in a careful and balanced fashion. The purpose of the present exercise is to indicate at what point in time such an option might be available rather than to specify exactly what choices should be made. Thus, the choice of repaying debt has been adopted in our projections on a purely notional basis. A similar result to the above could take place without as much increased borrowing if the commercial banks were prepared to write-off part of the interest payments due to them.

18. In recent years, Argentina has been characterized by high fiscal deficits and, as stabilization was set in place, by very low ratios of money to GDP--M1 to GDP was as low as 3% and will probably finish 1985 at about 6%. The dilemma facing the authorities is how to increase the availability of money in the economy without raising inflationary pressures. Accordingly, the money expansion must be very modest and in both scenarios we have assumed that the policy packages are consistent with an expansion of the money to GDP ratio to 10% of GDP over the next four years. The fiscal deficit will be very difficult to reduce over the short run given

the high debt servicing burden placed on public finances and the structural problems in state enterprises, particularly YPF (Yacimientos Petroliferos Fiscales). We have thus assumed that the deficit can be reduced to 3% of GDP during 1986, but that in the base case it will fall no further. In the high case the policy reforms, particularly in YPF, should allow a further drop to 2% of GDP, but this, we believe, is a reasonable and attainable long-run structural ratio of the deficit.

IV. Policies, Institutions, and Priorities

19. Argentina has the potential to reverse the current recessionary trends in economic activity and gradually achieve respectable growth rates while reducing its debt to exports ratio. Fulfillment of this potential in a high case scenario is predicated on the adoption of comprehensive policy reforms.

20. In a first stage, the Government has put into place a comprehensive program to stabilize prices, reduce the fiscal deficit and strengthen the external accounts. The next hurdle that needs to be overcome is the transition from a wage and price freeze (where, in effect, not all prices and wages have been frozen) to a regime of price flexibility. To proceed on this course without once again destabilizing the economy, the Government needs to undertake measures which should permanently reduce the fiscal deficit and avoid using Central Bank credit to finance it, so as to create an environment for breaking medium-term inflationary expectations as it implements a concerted and gradual phasing out of the freeze. Such a phasing out should be done gradually and with sufficient support from producers, retailers and trade unions to avoid a rekindling of inflation.

21. The Government has stated its intention to address the root causes of Argentina's economic woes through comprehensive medium-term program of structural reforms. At the moment though it is still seeking its way, the elements for an integrated program have not yet been put together. It is considering to eliminate most quantitative restrictions on imports and replace them by tariffs. It is also planning to reduce state participation in the industrial and petroleum sectors. Further, it has indicated interest in Bank support for the privatization of its petrochemical holdings in the Fabricaciones Militares complex. However, the Government is moving only slowly in opening up petroleum exploration and exploitation for the private sector; likewise, in telecommunications, it has decided to entrust the expansion of the seriously defective telephone network to a public sector company (ENTEL) that has been unable to operate the existing systems satisfactorily. The Government needs to act on several fronts simultaneously: improve the incentive system for the private sector, define a policy for the public sector, streamline public expenditures, eliminate distortions in the financial sector, and strengthen the infrastructure required to support exports. The following paragraphs summarize our judgment on the relative importance of the policies and measures required to achieve the objectives mentioned above.

22. The Government should give first <u>priority to eliminating export taxes and quantitative import restrictions</u>. As of October 1984, the average import tariff was about 23%. A comprehensive trade policy reform,

including lower rates of effective protection only seems feasible once the economic recovery is well under way. Meanwhile, a gradual process of rationalizing the trade regime should support a concerted major drive to promote industrial exports mainly by reducing import restrictions, applying temporary admissions automatically and facilitating export financing. We have estimated that such a program, which could be supported by Agricultural Sector, Trade Policy and Export Promotion Loans, could generate incremental foreign exchange earnings of about US$1.2 billion from agricultural exports and of US$1.3 billion from industrial exports by 1990; however, this would require new offsetting fiscal measures.

23. Policy reforms in oil and gas are crucial for the high case scenario to materialize. The Government has indicated its intention to allow for a broader role of the private sector, both foreign and local, in the development of Argentina's hydrocarbon resources. However, it has been slow in defining specifics and in taking concrete action. Key among the requirements for the promotion of gas and oil developments are more attractive and stable incentives for the private sector, award of attractive new exploration and exploitation contracts, limitation or elimination of convertibility risk, access to domestic credit (i.e., "apex" financing arrangements) and rationalization of the price structure of hydrocarbon products in line with economic costs. There are also possibilities to enhance the participation of the private sector in the gas transportation and distribution system. We have estimated that Argentina has the potential to export around 70,000-120,000 barrels per day amounting to US$0.6 to US$1.0 billion of crude oil/petroleum (at US$24 per barrel) products by 1990. Moreover, annual investment requirements during 1986-90 of about US$1 billion for petroleum and US$0.5 billion for gas cannot be met by the public companies. At the same time YPF is the single major source of the public sector deficit, because it keeps for itself the taxes it collects for the Central Government, since its expenditures are much larger than its revenues. Bank lending in support of rational hydrocarbon development policies could include Refinery, Supplemental Oil an Gas Sector (policy-based), Gas Pipeline and Oil and Gas Private (project financing) Loans.

24. Eliminating the existing distortions which do not allow capital markets to operate efficiently will be a key to stimulating investment for capacity expansion. However, because of the risks of a financial crisis involved in a comprehensive financial sector reform, the needed reform has to proceed in stages. First, real interest rates could be reduced sharply if longer-term inflationary expectations were to be broken. A fall in real interest rates would also become possible by removing present surcharges, shifting the burden of reserve requirements to sight deposits with very low requirements on time deposits, and reducing controls to direct credit. The Government would also need to strengthen the supervisory role of the Banking Superintendency. In particular, the Government should not give preferential treatment to government banks. Second, the Government should initiate a program to restructure the sector through mergers and acquisitions by means of increasing minimum capitalization requirements and temporary fiscal measures to promote consolidation. However, the Government needs to proceed with caution, perhaps first concentrating on public sector banks, particularly the provincial banks that are inefficient and close them down. A proposed Financial Sector Reform Loan has tentatively been included in our program.

25. A framework for reforming the public sector should include the medium-term role of the public sector in the productive areas; namely, to both restructure (oil and gas, railways and telecommunications) and privatize public sector enterprises (petrochemicals and steel). Moreover, its share of public sector investment in total investment should gradually decrease. The public sector should not have preferential access to credit. Budgetary policy should be such that only transfers for equity take place and that operating losses of enterprises or the public banks not be financed by either the Central Bank or the budget, except on a temporary basis. At the same time, the public sector should have freedom to set its prices within certain regulatory limits for monopolistic services. Finally, enterprises should be managed as commercial entities, including policies over wages, recruitment and dismissals. A proposed Technical Assistance Loan would assist in formulating the above framework.

26. In the context of implementing the reform of the public sector, the Government also has to place emphasis on reorganizing its own house. The thrust of this effort should be to reduce public sector employment (through attrition) and to improve the efficiency of public sector enterprises including adequate cost recovery policies. Analytical work to improve the efficiency of public enterprises [especially YPF, ENTEL, Railways, SOMISA (steel)] has been initiated. Preliminary results indicate that restructuring (technical, financial and organizational/management) of these enterprises could lead to major gains in their efficiency and competitiveness, while at the same time strengthening public sector finances. The Bank could support restructuring, which would be a lengthy and difficult endeavor through sector loans in transport, energy and enterprise specific loans for SOMISA and ENTEL.

27. Similarly, the Government will need to prepare and review carefully the priorities of a medium-term public investment program. Our recent review of a preliminary investment program has indicated the following priorities in the transport and energy sectors, which account for about half of public sector investment: (i) improvement of port services; (ii) reconstruction/maintenance/graveling of high-trafic roads; building of feeder roads for the main export corridors; (iii) enhanced oil recovery/liquid extraction and gas gathering projects, acceleration of oil and gas pipeline construction; (iv) reinforcement of power transmission/distribution lines. The Government has to strike a better balance between new investment and maintenance; to introduce uniform investment criteria; define priority projects; and establish a central review for all public investment projects. In this connection, a central project processing/monitoring unit would go a long way in helping to implement the criteria and investment priorities that are agreed upon. As regards investment financing, improvements in tax administration and rationalization of public tariffs should be undertaken simultaneously with the elimination of earmarked funding (special funds) which are not conducive to efficient resource allocation. The Bank could support government efforts in this context through Technical Assistance, Bahia Blanca Ports I/II, Yacyreta supplemental, Power Distribution and Transport Sector Loans.

V. Scenarios

28. This section is a description of the type of evolution of the economy that we expect to see under the two different policy scenarios. The differences in the scenarios are essentially a matter of degree in timing and intensity of implementation of policy reforms, which would condition, again as a matter of degree, a return of confidence and, consequently, direct private investment (both domestic and foreign). As was pointed out earlier, the base case requires the maintenance of the Plan Austral and thus needs a significant degree of continued policy action on the part of the authorities. As noted, a true base case would imply a return to the chaotic and disastrous policies of the early 1980's and would be characterized by escalating debt, high inflation, declining per capita consumption, and stagnant GDP. The Plan Austral represents a bold repudiation of these policies on the part of the Argentine people and an implicit assertion that the Plan, even with its present and future sacrifices represents a minimum acceptable state of the economy.

29. The central sequence of policy actions and responses in the economy centers on the necessity at first on increasing exports as rapidly as possible so as to address the overriding balance of payments and debt constraints. Thus the policies in the immediate future are aimed at exportables and at the incentives to export. As the economy has a moderate degree of unutilized capacity in most sectors, the initial thrust will be on pricing. To this end the agriculture policies are directed at a reduction in export taxes and a reformation of credit policies. Similarly in the manufacturing sector where trade policy reform is an early priority. In both these sectors there is enough capacity that it will be several years before new investments need come on stream. In order to effect this however, it will be necessary for a reform of the financial sector to have taken place, ideally by early 1987, so as to lower the real cost of capital to investors while simultaneously increasing the incentives to savers. A second key to the recovery will be the oil and gas sector. Here the country has a substantial potential, not only for natural gas, but also for petroleum. In the short-run the issues can best be addressed by the encouragement of the private sector in the industry, by allowing the private sector into the exploration and development phases, by reducing part of YPF's investment program (drilling and exploitation) and giving the private sector the responsibility to undertake it, and by encouraging technical developments in the extraction of existing wells. Finally, there are issues that affect the fiscal strength of the country including an early start on attaining adequate pricing in natural gas, power, and water and sewerage, improved planning, the scaling down of the public investment program, and monitoring of public sector investment. This latter program should not only be aimed at allowing the private sector greater participation in productive sectors, but also in focussing the investment of the public sector in key infrastructural areas (such as ports and transport corridors).

30. In the high case scenario, a very significant policy measure concerns the building of gas pipelines and this requires an early settlement of the COGASCO issue. This policy initiative will allow a dramatic change in the energy accounts of the balance of payments, by allowing the gas associated with petroleum deposits to be taken off and thus allowing a substantial increase in petroleum output. In addition this scenario will

require high levels of private investment in the sector. In both cases, it would be necessary to improve extraction from existing wells, private sector participation in exploration and development and moderate private sector investment. In the agricultural sector, while the base case would only envision export taxes being dropped to the May 1985 level, the high case would phase out most of them and would focus on public investment in the transport infrastructure between the producing areas and the ports. In the trade field, the base case will require a gradual elimination of quantitative import restrictions. The high case assumes a significant opening up of the economy and may require further improvements in the competitiveness of the exchange rate, but will certainly require coherent and stepped-up efforts on export promotion and improved management and recapitalization of enterprises. In the base case scenario, adequate pricing policies will be required in the power sector. In the high case scenario, the power sector will require expanding the transmission and distribution network and the completion of ongoing power generation projects (including Yacyreta) based on adequately projected demand requirements. Finally the distinguishing characteristic of the high case scenario will be the expanded and enhanced role that the private sector must play in the economy. Private investment must double in real terms within the next seven years. This can only take place with a coherent and productive environment for the private sector coupled with an efficient financial system.

VI. Action Program

31. The policy reform proposals included in the high case scenario should be implemented on the basis of annual action programs. This section outlines in detail the annual action program for 1986. A summary of the annual action programs for 1987-90 is outlined in the attached Policy Matrix (Annex I) These of course would be reviewed and modified to take into account the results of the implementation of each annual action program and changes in the external environment. Discussion of the policy requirements under the base and high case scenarios for 1986-90 is included in Section V above. A summary discussion of sector policies is included in the attached Sector Policies (Annex II).

1986 Action Program

32. The 1986 program would focus on: (a) agreement on a medium-term macroeconomic program; (b) preparation of a medium-term public sector investment and financing plan and external borrowing programs; (c) adoption of revenue and expenditure measures required to meet the targets under the Government's stabilization program; (d) gradual phase-out of the wage and price freeze; (e) exchange rate measures to maintain Argentina's international competitiveness as required; (f) improvement of the effective exchange rate in agriculture; (g) gradual elimination of about half of all import prohibitions and quantitative restrictions; (h) improving the administrative mechanisms of trade management; (i) facilitate financing for exports; (j) initiate support of export services as part of export promotion; (k) initiate reforms in the financial sector, and (l) introduce measures which will produce a structural reform in the operation of enterprises in the energy sector. More specifically, this would require the implementation of a number of sectoral actions.

33. Agriculture: (i) removal of the temporary increases in export taxes imposed in June 1985 (see para. 36 for offsetting revenues); (ii) removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985 and redesignation of tractors and agricultural machinery from the "prohibited" to the "free" classification for imported goods; and (v) initiation of studies to promote exports and improve efficiency in the sector.

34. Trade: (i) import liberalization through the elimination of most import licensing requirements: (a) reclassification of about 50% (2,000) tariff positions from prohibited to free and partial replacement by tariffs; and (b) reclassification of about 50% (650) tariff positions from prior consultation to free and partial replacement by tariffs; (ii) achievement of free trade status for export industries, through the reform of the temporary admission regime for imported inputs, along the following lines: (a) simplification of administrative procedures; (b) guarantee of automatic access for any products; (c) coverage of indirect exporters; (d) extension to capital goods used for export production; and (e) extension of the tax reimbursement scheme to exports processed under the temporary admission regime; (iii) simplification of export procedures, eliminating all unnecessry interventions by public sector agencies; and (iv) preparation of terms of reference for studies needed to support the adjustment process: (a) study of tariff protection with a view to actions that will reduce tariff dispersion; and (b) study on the indirect tax content of exports, with a view to actions to rationalize the system of tax rebates to exports, as well as strengthening it vis-a-vis trading partners that might be tempted to impose countervailing duties; (v) removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; (vi) facilitate financing (pre- and post-shipment) by banks; and (vii) develop a common integrated data base on markets and products for exporters.

35. Financial System: (i) lowering reserve requirements; (ii) reduce controls to direct credit; (iii) preparing a program for rebuilding of the financial sector; and (iv) strengthen the supervisory role of the Banking Superintendency.

Public Sector

36. Fiscal System: (i) identification of alternative sources of fiscal revenues and taking appropriate measures as needed to maintain the fiscal deficit at levels commensurate with the ceilings of the Government's stabilization program (estimated at about 3% of GDP for 1986); (ii) satisfactory progress on a program for preparation and implementation of federal land tax; and (iii) tax administration: (a) initiate the improvement of information flow by unification of taxpayer identification for each separate tax collecting entity; phase out expensive visit system in favor of distribution of information on cross-compliance; increase penalities for evasion; and concentrate audit efforts on VAT; (b) eliminate tax amnesties; and (c) focus excise tax collection on commodities where the Government has direct control over the collection.

37. Public Enterprises: (i) decision to restructure and privatize; (ii) initiate reduction of employment through attrition; (iii) introduce

managerial accountability and cost accounting; (iv) initiate real tariff increases in electricity and water supply enterprises; (v) minimize coal investments; (vi) postpone major hydroelectric projects (Yacyreta); (vii) cancel the expansion of the petrochemical production capacity in Bahia Blanca, of the SOMISA new sheet steel rolling mill and the shipyards expansion; and (viii) establish clear criteria for public enterprise management on a commercial basis.

38. Energy: (i) reduction of YPF budget deficit (from projected US$1.1 billion to US$0.4 million) through: (a) cuts in the investment program. Cut proposed program of US$1 billion to US$600 million (with the private sector expanding investments to compensate for the reduction) by reducing exploration and production activity from a proposed 130 exploration and 850 production wells to 50 exploration and 250 production wells, focussing on high-yielding fields and secondary recovery projects making maximum use of existing shut-in wells and well repairs. New oil production contracts with private companies would supplement YPF's production efforts. Continue infrastructure investment, mainly refinery conversion, which should be completed on time and could not be farmed out to the private sector at this stage; (b) cuts in the operating budget. Establish action plan to achieve operating cost reductions estimated at about US$0.3 billion through savings due to reduced drilling activity (US$0.2 billion) and efficiency improvements (US$0.1 billion); and (c) introducing a monitoring mechanism. Establish independent monitoring body reporting to the Ministry of Economy which supervises YPF's budget programs on a continuous base and approves/countersigns major decisions/expenditures; (ii) private sector oil exploration and production: (a) new private oil production contracts. Establish action plan to farm out explored areas to local and foreign oil companies under production contracts. Achievable private sector investment estimated at US$200-300 million annually; (b) private oil exploration contracts. Complete first bidding round for 32 areas (of 164 already defined areas) for new risk contracts by February 1986. Complete second round for another 30 areas during 1986. Estimated investment possibilities: about US$200 million annually once drilling phase of awarded contracts starts; and (c) financing of private sector operations. Allow export of crude oil or petroleum products for limited recourse financing schemes. Improve disbursement procedures for World Bank funds managed by BANADE. Utilize IFC funds as matching funds to mobilize additional on-lending loans from commercial banks; (iii) YPF organization improvement: (a) Establish action plan to implement accounting and financial management systems to allow cost control by activity and clarify accountability of YPF managers; and (b) institute a high-level government committee to prepare options and approaches to restructure YPF and to introduce workable competition in the petroleum sector; (iv) gas sector: (a) begin Northern Pipeline expansion with clear schedules and budget provisions; (b) prepare transmission pipeline expansion program (Central West and new Western Pipeline); (c) resolve the COGASCO dispute in 1986; and (d) introduce new financing schemes such as limited resource financing guaranteed by petroleum export revenues; and (v) power sector: continuation of real tariff increases.

39. Water and Sewerage: Continuation of real tariff increases.

VII. Difficulties in Implementing Policy Reform

40. The proposed policy reform program outlined in the preceding sections constitutes a major task. With the exception of privatization, the proposed policy reforms in the agriculture, trade, energy and financial sectors are necessary for the high case scenario to become viable.

41. The reform of agricultural sector policies will be criticized by the conservative agricultural producers who are dead set against a land tax. Within the Government, at a time of great fiscal stringency, the Secretary of the Treasury is justifiably uneasy about the elimination of taxes that are very easy to collect (export taxes) and their replacement by a new tax that may prove harder to collect (the land tax).

42. Trade policy reform is an extremely sensitive area. The previous import liberalization attempt was a bitter disappointment: entire industries disappeared, industrial employment declined in absolute terms, and small and medium scale industries were particularly hard-hit; and the country had nothing to show for it. Thus, any effort perceived as reviving the "Martinez de Hoz policies" would be doomed to failure now. For this reason, the proposed program of policy reforms focuses on achieving free trade status for export industries, shying away from a comprehensive tariff reform that would decrease the already low average effective protection and its dispersion. This would be a way of maintaining the dialogue open on an issue whose sensitivity might diminish in a few years. Proceeding differently--that is to say, raising the issue of decreases in average effective protection at this point--would be extremely counterproductive. Business and labour leaders would present a united opposition front. The better investment climate that the Government is painfully trying to reconstruct would deteriorate sharply and the Bank's policy dialogue would be seriously jeopardized. Yet it must be recognized that so long as the import regime remains restrictive, additional external financing under the Baker proposal or repatriation of Argentine assets now held abroad might have inflationary consequences.

43. The major reforms proposed in the energy sector are likely to provoke opposition from several sectors. Drilling contractors which now execute about half of YPF's annual drilling program, will vehemently oppose any cuts that jeopardize their service contracts. This would be supported by provincial governments in oil-rich areas if reduced state production activity resulted in a loss of royalty payments and reduced employment of workers in the oil service industries. These concerns could be addressed by awarding a substantial amount of production contracts to private sector firms, which would shift risk and financing burdens to the private sector. In particular, foreign firms would be able to service capital more easily and could improve production efficiency more quickly than local firms. Moreover, any privatization of oil production, introduction of more competition or the restructuring of YPF, are likely to encounter resistance from YPF's management, unions, and political forces within the Radical Party (traditionally supporting public sector dominance of oil and gas activity). This could be addressed by the creation of new private sector jobs through the increase in private sector activity and by improving performance incentives within YPF. Basically, however, these groups will have to be convinced that the proposed policy reforms will

improve the Government's fiscal deficit and the balance of payments prospects.

44. The reforms proposed in the transport sector will receive strong opposition from the Transport Secretariat (within the Ministry of Public Works and Services) which does not concur with policy recommendations originating from development institutions. In addition, major changes in the railways will be difficult, given that these inevitably will require a massive reduction in personnel.

45. Financial sector reform is likely to be resisted by the owners and managers of those financial institutions that are least likely to survive and by the public sector-owned provincial banks. Since restructuring will unavoidably imply the closing down of some institutions and branches, it must be expected that, the banks' employees unions will agitate to defend their members' jobs. Pressure will be applied on the Government to absorb the redundant employees (about 30,000) which it will not be in a position to employ.

46. Privatization efforts in all sectors are likely to be resisted, even by some groups within the Radical Party. The issue is complicated, moreover, by the administration's reluctance to antagonize the armed forces unduly, and the fact that some of the more obvious privatization cases are the Defense Ministry's steel and petrochemicals industries. Even in the event that privatization could take place, the availability of buyers and lack of financing could pose a serious constraint to divestiture.

VIII. Monitoring of Policies

47. The Bank would follow the Colombian model to monitor the progress of the Government's medium-term program. However, different from the Colombian case, we would expect that the Government enter into formal standby agreements with the Fund. Such monitoring would be implemented through yearly assessments of a medium-term macroeconomic and public sector investment programs. This would include the adoption and direction of policies to ensure the programs' future viability. Consideration of policy based loans which would include specific agreements on agricultural, trade, energy and financial sector policies and public sector reforms, and on a successful implementation of the above mentioned programs. We would push to reach an agreement with the Government on the above before we present a proposed Trade Policy Loan to the Board. We would also include in the programs specific agreements on the adjustments of prices of public utilities to appropriate levels, together with corrective actions on the overall economic program as required, and actions to increase the role of the private versus the public sector, including foreign investment. On the basis of the above, we would undertake regular supervisional exchange of views with the Government. The Bank's yearly assessment of the macroeconomic program would take into account the IMF's review of its stand-by agreement with the country, particularly as it relates to targets on net international reserves, the fiscal deficit, total credit of the Central Bank, net credit of the Central Bank to the public sector and the level of public sector debt on a quarterly basis. The Bank's overall assessment would incorporate the IMF's view on progress with respect to achieving and

maintaining export competitiveness in the current stand-by, and in subsequent ones, to be negotiated once the current one expires in March, 1986. As part of this process, we will propose to the Government that it prepare and send to the Bank two reports on a yearly basis, summarizing the status of implementation of the medium-term program to be agreed with the Government. The first status report would also serve as a basis for a mid-term review. These reviews would also form the basis for the release of the tranching under new policy based lending.

IX. Stabilization: Relationship with the IMF

48. The principal aim of our relationship with the Fund will be to develop an operationally effective understanding before their next stand-by negotiation (March 1986). The purpose of the proposed relationship will be to: (a) agree on a medium-term framework necessary for the country to become creditworthy and resume real economic growth; (b) agree on a stabilization approach that is compatible with growth objectives; (c) receive their input and support to ensure that the Government's medium-term investment program will be financially viable; (d) define the respective roles in monitoring; and (e) incorporate the IMF's view in progress with respect to stabilization and maintenance of export competitiveness in the Bank's overall assessment of the adequacy of the Government's medium-term macroeconomic program. Consistency between short-term stabilization and medium-term growth will be essential, and thus the Bank's and Fund's programs should be worked out concurrently. The IMF would be responsible for the short-term stabilization aspects of the medium-term program; the Bank would be responsible for the growth and efficiency aspects (Section VIII above). Continuous consultations would take place to ensure that stabilization and growth objectives are compatible with each other. In this connection, Fund/Bank consultations would also focus on the stabilization issues to be covered by Fund missions and on the issues which Bank economic missions and policy based lending operations would cover. The Fund's expertise in the fiscal area would be sought to complement our analyses regarding the introduction of new taxes in our policy based lending and for the supervision of the tax policy and tax administration activities in the proposed Technical Assistance Loan.

X. Financing Requirements

49. Given the above objectives, policies, and constraints, it is estimated that between 1985 and 1990, even with the best achievable policy package, the Argentine economy will require net flows (excluding IMF and direct foreign investment) of some US$8.7 billion, the bulk of which would have to be concentrated in the 1985-87 period. With the more modest policy package the flows would be more in the range of US$9.5 billion. It is envisioned that this would require gross disbursements of about US$18 billion and commitments of about US$14-15 billion in either case. The Argentine economy itself has not been characterized as one with large trade deficits. The country's indebtedness increased during 1979-82, mainly because of a misguided policy experiment which was followed by a huge capital flight and because of an unfortunate military action. For this

reason Argentina may develop the capability to repay its external debt if policies appropriate to fully utilize the country's potential are implemented, provided the Government does not opt for substantially higher consumption levels. In the base case, longer maturities for fresh money from the commercial banks would be required as compared with the high case where such borrowings could be repaid over a shorter period of time. In the base case, some 60% of the net flows would have to come from the commercial banks, concentrated mainly in the early years of the program. In the high case, the commercial banks' share would be somewhat lower (about 50%) as the potential to service the debt fully would appear sooner (1988 as compared the base case (1990). World Bank commitments for 1986 would amount to about US$630 million in both cases, since the level of commitments would be significantly firmed-up. From 1987 onwards, commitments would average US$500 million per year in the base case; and in the high case, US$800 million in 1987 and US$900 million per year during 1988-90. In the base case the World Bank share of debt outstanding and disbursed would be under 4% while in the high case, the World Bank share would go up to 5%.

ARGENTINA - PROPOSED MEDIUM-TERM ADJUSTMENT AND GROWTH PROGRAM

High-Case Scenario

Main Goals: (1) To restore and sustain real economic growth of 4% on average during 1986-90, and 4.4% during 1991-95.

(2) To expand exports in real terms by 5.4% on average during 1986-90.

(3) To maintain a sound balance of payments position, consistent with a reduction in the debt to exports ratio from 5% in 1985 to 3% in 1990.

Note: * indicates actions to be implemented in one year; ——— indicates actions covering several years.

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
A. TRADE, INDUSTRY AND AGRICULTURE								
1. Exchange Rate Policy	Maintain international competitiveness	Crawling peg devaluations during first half of 1985; 18% devaluation in June 1985; continuing depreciation of the real exchange rate vis-a-vis major trade partners	Maintenance of competitive exchange rate policy through periodic adjustments which are equal to the difference between domestic and international inflation.	———	———	———	———	———
	Improve the effective exchange rate in agriculture	Export tax on wheat reduced from 26.5% to 15% (September 1985); smaller reductions in other commodities	Phased reduction of export taxes on agricultural commodities by 1988 to no more than 50% of the rate in force on May 1,1985; by 1990 to 5% of agricultural exports; and by 1991 complete elimination.	———	———	———	———	———
	Improve the effective exchange rate in industry	Export taxes on agroindustrial exports eliminated (August 1985)	Full rebates on direct and indirect taxes paid by exporters.		*			
2. Import/Export Regime	Eliminate prohibitions and quantitative restrictions		Phased elimination of most import licensing requirements: (i) reclassification of 4,000 (100%) tariff positions from prohibited to free list and partial replacement by tariffs	———	———			
			(ii) reclassification of 1,300 (100%) tariff positions from prior approval to free list and partial replacement by tariffs	———	———			
			(iii) redesignation of tractors and agricultural machinery from the prohibited to free list.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
3. Export Incentives	Provide inputs for exporters at world prices		Reform of the temporary admission regime for imported inputs:					
	Reduction of import tariffs		(i) guarantee of automatic access to any input;	*				
	Improve the administrative mechanism of trade management		(ii) gradual coverage of first-line suppliers of exporters;		*			
	Provide export support services and adequate and timely information		(iii) gradual extension to capital goods used for export production		*			
			Removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985	*				
			Preparation of studies needed (i) to rationalize the import tariff structure	—	—			
			(ii) to rationalize the structure of tax rebates for exports	—	—			
			Implementation of recomendations of above studies			—	—	—
			Simplification of export procedures, unification of agencies authorized to review and approve export applications	—	—			
			Formation of a joint organization to provide institutional support for marketing, storage, quality guarantee, legal assistance, lobby. Development of an integrated data base.	—	—	—		
4. Export Financing	Expand available resources		Removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; and encouragement of joint financing by banks	*				
			Review the level of financing subsidies.			—	—	—

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Allowance of export plans by firms as a basis to determine the amount of Central Bank credit lines for financing.		*			
			Broadening risk coverage of exporting firms.		*			
5. Agricultural marketing	Provide marketing infrastructure		Provision of market places and information for non-traditional agricultural products.		—	—		
	Expand transport and storage facilities		Promotion of private sector participation.		—	—		
6. Agricultural Credit	Financing increases in production.		Increase availability of short- and long-term credit.		*			
B. FINANCIAL SYSTEM								
1. Interest Rates	Reduce real costs of financing for investments.		Lowering reserve requirements on time deposits and sight deposits.	—	—			
2. Sector Restructuring	Create a healthier financial sector.		Increasing minimum capital requirements for financial institutions.		—			
			Temporary stock purchasing to facilitate adjustment and consolidation.		—	—	—	—
			Institutionalization of deposit and employment insurance systems.		—	—	—	
			Prepare a program for rebuilding of the financial sector.	*				
			Removal of the 2% ISSBE (Institute of Social Services for Bank employees) surcharge and its coverage by alternate fiscal measures.	*				
			Removal of the CRM (a device to reallocate differential reserve requirements).	*				
			Elimination of credit subsidies.		*			
			Reduce controls to direct credit.	*				
			Strengthen the supervisory role of the Banking Superintendency.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
C. FISCAL SYSTEM								
1. Tax Structure	Broaden the corporate tax base	Inclusion of rural properties to capital gains tax	Include profits on the sale of property		*			
	Improve the buoyancy of tax system, shift the burden to direct taxation		Elimination of most industrial incentive exemptions from VAT.		—	—		
			Focusing excise taxes on commodities where Government has direct control over the collection	*				
	Eliminate anti-export bias of the tax system		Introducing a federal land tax as export taxes are phased out		*			
2. Tax Administration	Improve the effectiveness of tax administration		Unification of tax payer identification for each separate tax collecting entity	—	—	—		
			Phasing out expensive visit system in favor of distribution of information on cross--compliance	—	—	—	—	
			Increased penalties for evasion and tax delinquency	—	—			
			Concentrating audit efforts on VAT	—	—	—	—	—
			Elimination of tax amnesties	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
D. PUBLIC SECTOR								
1. Central Govt., Public Enterprises and Investment	Definition of medium-term public/private sector roles		Decison to restructure and privatize public enterprises.	*				
	Improve efficiency of operations	A commission for the privatization of a group of public enterprises has been established.	Establish clear criteria for public enterprise management on a commercial basis.	*				
	Eliminate bottlenecks constraining trade expansion	A set of studies to guide public sector reform has been initiated.	Reduction of public employment through attrition.				—	—
			Wage differentiation and productivity bonuses.			—	—	
			Introduction of managerial accountability and cost accounting.	—	—	—		
	Phase-out public sector investment in non priority areas		Phasing out the production of goods and service lines.			—	—	
			Phasing divestiture of those enterprises that are not producing a true public good and/or service.			—	—	—
			Elimination of budgetary support to enterprises and of preferential credit.	—	—	—	—	—

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
	Mobilize and allocate resources to priority investments	National Development Council (CONADE) was reestablished to redirect public investment	Elimination of earmarked funds for non-priority projects.		*			
			Allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources;		—	—	—	
			continuation of real increases in water and electricity tariff revenues;	—	—	—	—	—
			and preparation of a medium-term public sector investment program and financing plan and external borrowing program.	*				
2. Energy Sector	Better use of energy resources	Major cuts and postponements in several energy projects	Government decision on the expansion of the gas transportation system through private participation Solution of the COGASCO dispute.	*				
	Enhance the private sector's role and improvement of oil export possibilities	A five-year investment program for the sector is being prepared	Award new exploitation and exploration contracts for oil and gas to private firms.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Provision of safeguards against the risks of convertibility for foreign investors.	*				
	Improve the operations of state oil and gas companies		Reduction of investment and operating costs, financial strengthening and streamlining of organizational structures, accounting and control systems, preparation of the restructuring options for YPF.	——	——	——		
	Mobilize potential financial resources		Adjustment of the price of natural gas taking its long run opportunity cost as a guide.	——	——			
	Promote energy conservation		Adjustment of the price of diesel as a function of the gasoline price, preparation of the deregulation of oil and petroleum products.			*	——	——
			Design and implementation of an energy conservation program including price and taxation aspects.			——	——	
			Reviews of the energy efficiency of the power sector and of the possibilities for conversion and savings.		——	——	——	——
			Minimization of coal investments and postponement of major hydroelectricity projects.		*			

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
3. Transport Sector	Reduce deficits Provide adequate facilities for export trade		Assurance of adequate cost recovery in ports, channel dredging, and railroads and the introduction of road user charges.		—			
			Strengthening of transport planning and intermodal coordination.		—			
			Consolidation of agencies working in the same sector.		—	—	—	
			<u>Railways</u>: Overhauling company, cutting uneconomic lines, providing bulk freight, improving maintenance, elimination of electrification schemes.		—	—	—	—
			<u>Highways</u>: Better maintenance of main traffic corridors, concentration on feeder roads with higher traffic.		—	—	—	—
			<u>Ports and Maritime Transport</u>: Deregulation of offshore storage/shipping, containerization, tugboat services.		*			
4. Restructuring	Restructuring to improve efficiency and competitiveness of basic industries		SOMISA: cut costs, balance production lines and strengthen management/administrative practices.				—	—
			ENTEL: improve operation and managerial efficiency.				—	—
5. Privatization	Programs for privatization of public enterprises		Petrochemicals: (i) identify potential investors;		—			
			(ii) negotiate the sale price value of assets;				—	—
			(iii) define the vehicle of transfer of assets to private investors.				—	—

SECTOR POLICIES

1. This section identifies the major sectoral features that are necessary for policy reform to resume and sustain medium-term growth in Argentina. The purpose of the policy framework is to identify factors that have constrained growth, define policy objectives to eliminate such constraints, recommend specific policy changes, and indicate the possible effects of the proposed policy changes.

2. There are two major constraints for the resumption of sustained growth in Argentina: (a) the underlying distortions in the economy and (b) the inefficiencies in the operation of the public sector. Elimination of these constraints requires improving the incentives system necessary for a more intensive use of resources to increase production and exports, and undertaking a series of actions to improve the efficiency of the public sector. Carrying out these tasks will require the removal of distortions in the trade regime, the phase-out of the price freeze, restoration of domestic financial markets, the strengthening of the tax system and an overall improvement of the machinery of government, notably, sound public investment screening mechanisms, requiring public enterprises to operate like commercial entities, and defining an adequate framework for an expanded private sector role. Thus, this section is divided into two parts. Part I deals with the incentives system necessary for the resumption of growth and focusses on the elimination of distortions, reformation of domestic financial markets, and increasing the effectiveness of the tax system. Part II deals with improving the efficiency of the public sector, and focusses on the public sector investment program, with special emphasis on the energy and transport sectors which comprise over half of the public sector investment program. It also examines the possibilities of restructuring and privatization of public sector industrial enterprises as a means to help reduce the Government's financial burden and public sector deficits, and to increase industrial efficiency, competitiveness and exports.

I. IMPROVING THE INCENTIVES SYSTEM

AGRICULTURE

A. Analysis

3. The agricultural sector has been growing below potential as a result of pricing policies that have: (a) depressed domestic prices for outputs through export taxes; and (b) artificially raised the costs of some key farm inputs through import tariffs and quantitative restrictions. As a consequence, most farmers have opted for low-risk; lower-input technologies which led to a significant underutilization of production and export potential. Also, the inadequacy of transport, storage, information and marketing facilities has raised the final costs of agricultural products and discouraged the production of new commodities.

4. The total agricultural sector credit portfolio in each of the last few years has been less than 50% of the portfolio registered in 1980. The economic uncertainty has negatively affected the demand for investment credit. In the case of short-term production credit, inadequate supply by the Banco de la Nacion and provincial banks has been a constraining factor. The Government's stabilization program has restricted credit further. Yet, maintenance of the growth of the agricultural sector will require substantial increases in both production and investment credit.

5. Policy objectives in agriculture should focus on: (a) reducing export taxes on agricultural products, providing alternative sources of fiscal revenue to compensate for the export tax reduction so as to maintain the overall fiscal deficit at satisfactory levels; (b) rationalizing import laws and regulations on agricultural inputs, (c) strengthening marketing efforts; and (d) providing sufficient credit resources to the sector.

B. Policy Recommendations

6. Specific changes recommended include:

(a) phased reduction of export taxes on agricultural commodities. The timetable of such an export tax reduction should include by: (i) January 1986, the removal of temporary increases imposed in June 1985; (ii) end-1986, the reduction of export taxes to no more than 70% of the rates in force on May 1, 1985; (iii) January 1988, the reduction of export taxes to no more than 50% of the rates in force on May 1, 1985; (iv) January 1990, the reduction of export taxes to 5% of the FOB value of agricultural exports; and (v) January 1991, complete elimination;

(b) introduction of a federal land tax and of alternative tax provisions to compensate for the revenue losses resulting from the export tax reduction program;

(c) removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985;

(d) redesignation of tractors and agricultural machinery from the "prohibited" to the free imported;

(e) marketing policies should be geared to: (i) promote the participation of the private sector, especially cooperative organizations, marketing; and (ii) provide marketing infrastructure to promote the development of new agriculture commodities; and

(f) make adequate resources available to financial institutions to meet the demands for both long-term and short-term credit in the sector.

C. Potential Results

7. The policy reforms would stimulate increases in agricultural production and exports by: (i) increasing domestic producer prices, bringing them closer to international prices and improving benefit-cost ratios for investment and production inputs; (ii) reducing the subsidy from producers to consumers; and (iii) improved marketing and increased credit. The introduction of a production-neutral federal land tax substituting for production-negative export taxes would represent a structural change in Argentina's taxation system.

MANUFACTURING

A. Analysis

8. Argentina's manufactured exports have been influenced substantially by the overall trade regime, which has, in the last five decades, been largely protectionist, creating a strong inward-looking bias in the economy. Industrial export promotion has been generally seen as secondary to import-substituting industrialization. As a number of incentives and disincentives for different products were introduced, a multiplicity of effective exchange rates emerged, with exports of traditional goods receiving the lowest rates. The system ultimately succeeded neither in eliminating the anti-export bias in the highly protected industries nor in sustaining the traditional manufacture and agriculture. The incentives regime was rendered particularly inadequate during the 1977-81 import liberalization attempt. Argentina's manufacturing sector is still badly shattered by that unfortunate import liberalization experience, adopted concurrently with a revaluation of the domestic currency.

9. The present tariff regime has been in place since January 1984. As of October 1984 (the last date for which detailed information is available), the range of tariff duties was 0-38%, with an average rate of 22.8%. The average tariffs for the major sectors of the economy were, in fact, quite close to that mean, and they point to little dispersion of average tariffs across major economic sectors: in the agriculture and mining sectors, they are, respectively, 19.9% and 25.2%, while in the manufacturing sector, 22.9%

10. Manufacturing has the potential for export-oriented output growth, with attendant foreign exchange earnings and employment creation. The sector lacks a clear development strategy, institutional support and consistent policy signals. The main issue is how to redress the strong anti-export bias built onto the complex systems of tariff and non-tariff protection while maintaining an exchange rate adequate enough to restore export competitiveness. Policy objectives in manufacturing should focus on the implementation of an outward looking development strategy by introducing reforms to reorient the economy towards export promotion. This should include: (a) phased elimination of import prohibitions and quantitative restriction, and of export restrictions; (b) reorientation of export policies so as to reduce the discretionary element and provide automaticity and uniformity of access to incentives and foreign exchange in order to provide free-trade status for export industries; (c) improvement of the administrative mechanisms of trade management; and (d) preparation of

studies on tariff protection and rationalization of the system of tax rebates to exports as a basis for further policy reforms.

B. Policy Recommendations

11. Specific changes recommended include:

(a) the gradual elimination of most import licensing requirements as follows: (i) reclassification of about 4,000 (100%) tariff positions from prohibited to free and partial replacement by tariffs; and (ii) gradual reclassification of about 1,300 (100%) tariff positions from prior consultation to free and partial replacement by tariffs.

(b) achievement of free trade status for export industries, through the reform of the temporary admission regime for imported inputs as follows: (i) simplification of administrative procedures; (ii) guarantee of automatic access for any input; (iii) coverage of indirect exporters; (iv) extension to capital goods used for export production; and (v) extension of the tax reimbursement scheme to exports processed under the temporary admission regime;

(c) simplification of export procedures, eliminating all unnecessary interventions by public sector agencies;

(d) preparation of the following studies needed to support the adjustment process: (i) tariff protection, with a view to reducing tariff dispersion; and (ii) the indirect tax content of exports, with a view to rationalizing the system of tax rebates to exports, as well as to strengthen it vis-a-vis trading partners that might be tempted to impose countervailing duties;

(e) extension of export financing: (i) removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; (ii) facilitating joint financing by banks; and (iii) reviewing the level of financing subsidies; and

(f) establishment of an export assistance and information system: (i) allowance of export plans by firms as a basis to determine the amount of Central Bank credit lines for financing; (ii) broadening risk coverage of exporting firms; (iii) formation of a joint organization to provide institutional support for marketing, storage, quality guarantee, legal assistance, lobby; and (iv) development of a common, integrated data base.

C. Potential Results

12. The following projections for 1986-90 reflect the potential impact of the proposed policy changes, predicated on the basis of a timely implementation and supported by massive export promotion efforts and by improved management and recapitalization of enterprises in the private sector: (a) exports of manufacturing goods are projected to grow on average by about 4.9% in real terms during 1986-90, from 0% in 1985; (b) imports of goods are projected to grow on average by about 4.7% in real terms on average during 1986-90, from a drop of 3% in 1985; and (c) the current account

deficit of the balance of payments is projected to fall from an estimated US$2.2 billion in 1984 to an estimated US$2.1 billion in 1986 and turn into surplus of US$1.2 billion in 1990.

FINANCIAL SYSTEM

A. Analysis

13. The efficiency of the financial system will be a key element in the speed and effectiveness of the recovery in Argentina. Once the economy has reached capacity in the productive sectors, the availability of credit at realistic interest rates will be the key to stimulating investment in future productive capacity. The financial sector, having been severely battered over the past decade, is in a poor position to provide the type of efficient service that the economy is going to need. It is currently characterized by substantial overexpansion, poorly run banking institutions, almost inexisting supervision by the Banking Superintendency, and by intermediation spreads of as much as 4% real per month reflecting not only an overall scarcity of funds, but more importantly, substantial inefficiencies in the system itself. Even with more normal levels of money supply in the economy, it is estimated that financial institutions would need spreads of 1.5% to 2% per month to break even. In effect, the system has operated like an oligopoly, despite the large number of participant institutions, protecting the least efficient ones and guaranteeing large economic rents to the more efficient ones. Analysis of the sector also indicates that low productivity is not confined solely to small institutions and that a policy of encouraging mergers will not, in itself, solve the problem. Other factors working to increase interest rate spreads include the 2% surcharge used to finance the Institute of Social Services for Bank Employees (ISSBE), the CRM (a device to reallocate the burden of differential reserve requirements) and various mechanisms to direct credit.

14. The goal of the reform of the financial sector should be to eliminate distortions and allow the market to define the spreads between the deposit rate and the lending rate. The increased monetization of the economy will then be reflected in declining interest rates.

B. Policy Recommendations

15. While a return to more normal levels of money supply in relation to GDP will certainly help to create a more healthy financial sector, there are a number of specific policy measures that must be taken within the sector itself:

(a) restructuring of the sector by means of (i) increasing the minimum capitalization required for financial institutions; (ii) temporary fiscal measures to encourage consolidation; and (iii) a program aimed at public as well as private banks and at large as well as small;

(b) removal of the ISSBE surcharge and its coverage by alternate fiscal measures;

(c) removal of the CRM, recognizing that its allocative function has never worked efficiently;

(d) shifting the bulk of reserve requirements on sight deposits with a very low requirement, say 10%, on time deposits;

(e) elimination of credit subsidies.

(f) reduce controls to direct credit; and

(g) strengthen the supervisory role of the Banking Superintendency.

C. Potential Results

16. The above reforms should be sufficient for the market to function, lowering real intermediation spreads and allowing the development of an interest rate structure that would attract deposits while not discouraging investment in new plant and equipment. The restructuring of the banking system is bound to be gradual, however, and the economic and political costs of required adjustments may be high.

TAX ISSUES

A. Analysis

17. Argentina's basic tax structure is sound and appropriate for its level of development, including taxes on income, wealth, and value added. The revenue generated by the tax system, however, has been characterized in recent years by high volatility. Poor tax administration and widespread leakages through exemptions have led to a serious deterioration of government tax revenues. Total taxes collected are less than 20% of GDP. Income taxes amount to only 1.5% of GDP, and the value added tax (VAT) yields, in spite of the 18% rate, only 3.5% of GDP. Customs and excises are too high a share of revenues for a country of Argentina's level of development and create significant distortions both on the supply and on the demand side of the economy.

18. Policy objectives in the tax area should focus on increasing the yield from the existing structure through better administration of income, value added, and wealth taxes. There is strong evidence that tax administration has been hampered by poor information, frequent tax changes, repeated amnesties, and by penalty interest rates substantially below the taxpayer's cost of capital. Argentina's goal should be to raise tax revenue within the existing tax structure with emphasis on the elimination of tax exemptions and loopholes.

B. Policy Recommendations

19. Specific changes recommended include:

(a) taxes on foreign trade: to be significantly phased out for agricultural exports;

(b) property taxes: introduce a production-neutral federal land tax, including an accurate cadastre;

(c) tax administration: (i) unification of taxpayer identification for each separate tax collecting entity; (ii) phasing out of expensive "visit" system in favor of distribution of information on "cross compliance"; (iii) concentration of audit efforts on VAT; (iv) sharply increased penalties for evasion; (v) penalty interest for delinquency to be set significantly above taxpayers' cost of capital; and (v) elimination of amnesties;

(d) income taxes (corporate): to be left largely as is except to: (i) broaden tax base; and (ii) include profits on the sale of agricultural properties;

(e) wealth taxes: (i) to be extended (due to run-out in 1985) as is; and (ii) to eliminate deduction of 50% of assessed value of agricultural property;

(f) taxation on goods and services: (i) turnover tax to remain unchanged; and (ii) in VAT eliminate most of exemptions given for industrial incentives purposes; and

(g) excise tax: (i) not to be broadened; and (ii) focus on commodities where government has direct control over the collection (e.g., gasoline).

C. Potential Results

20. The overall target would be for tax revenues to gradually reach 25% of GDP by 1990, a level which would be adequate to allow for real increases in public services and an increasing contribution of government savings to investment.

II. IMPROVING THE EFFICIENCY OF THE PUBLIC SECTOR

21. A framework for reforming the public sector should include the medium-term role of the public sector in the productive areas; through restructuring and divesting public enterprises. Public sector's share in total investment should also gradually decrease. Public enterprises should not have preferential access to credit. Budgetary policy should be such that only transfers for equity take place and that operating losses of enterprises not be financed by either the Central Bank or the budget. Finally, enterprises should be managed as commercial entities, including policies over wages, product prices, recruitment and dismissals.

PUBLIC SECTOR INVESTMENT AND FINANCING

A. Analysis

22. Since 1977, public investment has declined by 60% in real terms. In recent years, the Government has encountered difficulties cutting current expenditure and has resorted to sharp cuts in investment. The cuts have been made haphazardly, and essential services have deteriorated. The critical areas where deterioration has reached a scale to constrain the expansion of trade are the following.

(a) Port services are not adequate for an expanded volume of grain exports. The bottlenecks are likely to become even more serious if exports continue to expand.

(b) Exploration and exploitation of hydrocarbon resources have fallen behind the country's estimated potential. As soon as the economy recovers, consumption will increase and the country may face the danger of becoming an importer of hydrocarbons.

(c) Roads feeding main transport corridors are either lacking or have deteriorated seriously. The agricultural export potential (especially fruits/vegetables) is not being fully exploited because of high transport costs/quality deterioration resulting from incomplete/bad feeder roads.

(d) The telecommunications network is inadequate to meet the needs of business and residential users. Waiting lines for telephone installation stretch to 5-7 years, raising operating costs significantly.

B. Policy Recommendations

23. Policy reforms are extremely difficult to achieve in this sector. Some of the proposals outlined below have been previously recommended, as far back as 25 years ago. Specific changes proposed include:

(a) rapid completion of dredging and the reconstruction of hinterland services at the Bahia Blanca port; and encouragement of private sector to build river ports;

(b) concentration of YPF's (the State Oil Company) resources on oil exploitation and liquid extraction, gas gathering and enhanced oil recovery projects; and accelerating the projects of oil and gas pipeline construction, particularly those for Formosa oil fields and for Lujan de Cuyo;

(c) increased emphasis on road reconstruction and maintenance and gravel surfacing on roads with more than a minimum (e.g., 100) average daily traffic; shifting railway transport operations to bulk freight with unit trains over a basic network of 16,000 km; emphasis on railway track renewal and bridge/culvert repairs; and

(d) encouragement of private sector participation in the provision of telephone services.

24. The public investment budget will continue to be tight in the foreseeable future. At the same time, average public tariffs for users have already reached--with the exception of water supply and electricity--a level above which Argentine producers' international competitiveness could be negatively affected. Therefore, priority investments should increasingly have to be financed from increasing productivity, revenue sharing and cuts on non-priority investments. These are highly desirable but difficult to achieve.

(i) productivity increases: (i) reduction of public employees through attrition; (ii) provision of adequate wage differentiation and production incentives; (iii) reinforcement of managerial accountability and introduction of cost accounting in public enterprises; (iv) cutting uneconomic production lines and transport losses; and (v) restructuring of some enterprises to expose them to competition;

(ii) revenue sharing: (i) elimination of earmarked funds for non-priority projects; (ii) allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources; and (iii) real increases in water and electricity tariff revenues;

(iii) actions on non-priority investments: (i) in the energy sector minimization of coal investments and postponement of major hydroelectricity projects; (ii) in road transport, reduction of investments in upgrading/capacity, and decreases in "strategic" roads with very low traffic and in new paving; (iii) in railway transport, elimination of new electrification schemes, and reduction of investments in passenger traffic; (iv) in maritime transport slowing down the expansion of the merchant fleet; and (v) in industry, cancellation of the expansion of the petrochemical production capacity in Bahia Blanca, of the new sheet steel rolling mill by SOMISA, and of the expansion of shipyards.

ENERGY

A. Analysis

25. Falling proven oil reserves and heavy reliance on petroleum as the primary energy source jeopardize Argentina's self-sufficiency in liquid fuels. Substantial new drilling is needed to maintain production in order to avoid imports. Proven and potential reserves of gas are almost twice as important as those of oil, but increased use of gas (including its possible export) is constrained by the limited transport infrastructure. Rationalization of oil and gas development requires more attractive and stable incentives for the private sector, clarification of the latter's role vis-a-vis the Government's, bringing absolute as well as relative prices of hydrocarbon products more in line with the economic cost of fuels, and strengthening public sector agencies in the energy sector, notably their financial condition and planning framework.

26. The Government's past efforts in the oil and gas sector focussed on exploration and production of oil to assure self-sufficiency and substitution of relatively abundant gas for liquid fuels. Energy conservation received little attention. The petroleum sector has the potential not only to assure the country self-sufficiency in oil but also to produce significant surpluses for export. At the same time, it has the potential to contribute significantly to reducing the overall fiscal deficit. It would be possible to continue to substitute gas for liquid fuels if a significant expansion of gas transmission infrastructure can be achieved during the next three to four years. Over the medium and longer term, Argentina's oil and gas reserve base could be expanded and important energy conservation efforts should be supported.

27. Policy objectives on oil and gas should focus on the following areas: (a) developing the infrastructure for oil and gas transport; (b) defining an adequate framework for an expanded private sector role; (c) rationalizing price structures and taxation; (d) financial and institutional restructuring of major public enterprises in the energy sector; and (e) launching of an energy conservation program.

B. Policy Recommendations

28. Specific changes recommended include:

(a) infrastructure: (i) government decision on the expansion of the gas transportation system (and corresponding gas gathering, treatment, and distribution through significant private sector (local and foreign) participation. Specifically, whether to expand the Central-West pipeline or to construct a new pipeline from Neuquen via Bahia Blanca to Buenos Aires; and (ii) solution of the COGASCO dispute would also be an integral part of this decision;

(b) private sector role: (i) encourage private sector participation by awarding new exploitation and exploration contracts to private firms which have the financial and managerial capabilities to supplement YPF's efforts in order to expand oil and gas reserves; and (ii) limit or eliminate convertibility risks (i.e., exports of products as guarantee for foreign currency obligations) and facilitate access to domestic credit (i.e., "apex" financing arrangements to support private sector borrowing needs);

(c) public enterprises: strengthen financially YPF and gas del Estado and reorganize their accounting and control systems;

(d) pricing and taxation: (i) adjust the price of natural gas, taking its long-run opportunity cost as a guide; (ii) adjust the price of diesel as a function of the regular gasoline energy equivalent; (iii) review the level and structure of prices of other energy products; (iv) review relationship with energy conservation incentives; and (v) review the costs and benefits of the existing structure of taxation of the energy sector with a view to increasing efficiency; and

(e) conservation: (i) design and implement an energy conservation program including pricing and taxation aspects; and (ii) study of the energy efficiency of the power sector and of the possibilities for end-user conversion and savings.

C. Potential Results

29. Official reserve estimates assume that only 19% of the oil in the ground may be recovered. This appears low by international standards. It may well be that a recovery rate of around 25% or more is possible. This would increase proven reserves fron around 370 million cubic meters to over 600 million cubic meters of oil and would allow exports of crude oil or petroleum products of around 70,000 - 100,000 barrels per day amounting to US$0.6 - 1.0 billion (at US$24 per barrel). New resource discoveries combined with energy conservation efforts should allow Argentina to maintain self-sufficiency in energy use for the next two or three decades.

30. Over the next five years, annual investments of US$1 billion or more would be required in the petroleum sector and around US$500 million in gas transmission and distribution. Under the foreseeable constraints on government investment funds, neither YPF nor GdE will be able to finance such programs on their own, nor would they have the capacity to implement them. However, by involving the private sector and by using new financing instruments such as limited recourse financing and funds from international development banks, implementation of such investment programs would be feasible even in the present environment of tight public investment funds. The efficiency of these undertakings could be significantly improved by restructuring YPF and by deregulating the present pricing policy framework in the petroleum sector. YPF's investment program which was already reduced from a high of US$1.8 billion in 1980 to about US$900-1000 million (including dry wells) in 1985 could be further reduced to around US$600 million by the late 1980s. Offering areas for exploration to private sector firms could reduce investment needs for YPF by US$100-200 million per annum. New exploration contracts could decrease YPF's investment requirements for production and provide the capacity to achieve the export targets mentioned above before the end of the decade. US$200-300 million of investments per year appear to be an achievable target for private sector production activities.

TRANSPORT SECTOR

A. Analysis

31. Public enterprises in the transport sector are an important drain on the Treasury's financial resources on account of their operating deficits and their investment programs. At the same time, their efficiency has an important bearing on the profitability of export-oriented domestic production and on reducing the cost of bringing imports into the country.

32. The sector is beset by bottlenecks and idle capacity which go side-by-side as a result of poor resource allocation and disinvestment, serious deterioration of infrastructure, poor maintenance, and obsolescence of rolling stock and fleet. There is little intermodal coordination; responsibilities of transport agencies are unclear, and the roles of the public and private sectors remain largely undetermined. Funds are earmarked for specific modes of transport or institutions without taking into account demand and rate of return criteria. Planning systems, staffing and information are inadequate. The Ministry of Public Works and Services lacks systematic information on project preparation and monitoring. There has been a major loss of experienced and trained staff while underemployment of lower level personnel has increased.

33. Policy objectives in transportation should focus on: (i) measures necessary to allow public enterprises to operate like commercial entities, including increased prices for public services, and adequate cost recovery; and (ii) policies to improve sector planning, investment follow-up, reduce public sector investment requirements through increased private sector participation, and deregulate and privatize transport sector activities.

B. Policy Recommendations

34. Policy reforms are extremely difficult to achieve in this sector. Some of the proposals outlined below have been previously recommended as far back as 25 years ago.

(a) increased prices of public sector services to ensure adequate cost recovery in, ports dredging, and railroads, and the introduction of road user charges;

(b) improvement of efficiency of operation of the railways. Since this is an area where all previous efforts have failed, it would represent a major task. It should include: (i) reduction of manpower (currently 108,000), closure of uneconomic lines, generation of operation/line-specific economic information to allow the assessment of the merits of expenditure programs; (ii) an overall reduction of the 1986-90 investment expenditures by 60%; and shifts in investment priorities: from passenger traffic to bulk freight (using unit trains over a basic network of 16,000 km); from the expansion of rolling stock (limiting purchases to replacement needs) and new electrification schemes to track renewal and bridge and culvert repairs; and to investments to control of operations, including the coordination of broad-gauge lines;

(c) improvement of efficiency of operation of maritime and air transport. This should include: (i) reduction in total investment expenditure; introduction of a toll system to cover major reequipment costs; efficiency improvements of import dredging operations; and elimination of legal obligations to buy from domestic shipyards; and (ii) shifts in investment priorities from the expansion of the merchant fleet to dredging and port support services and elevators, and from a possible air fleet standardization investment to the improvement of air traffic control systems;

(d) strengthening of MOSP planning and follow-up including the restoration of national transport planning as part of the global public investment planning mechanism, and the elimination of earmarked funds. In most road transport, priorities need to be shifted (i) from upgrading/capacity increases to reconstruction (current investment projects allocate 73% and 26%, respectively, to the former and the latter); (ii) from projects that are not likely to yield acceptable rates of return (due to expected traffic levels below minimum), that are allocated 52% of total investment expenditure, to higher traffic corridors; and (iii) from new paving projects with expected average daily traffic (ADT) of less than 100 to gravel surface projects with higher ADT;

(e) initiation of institutional reforms such as consolidation of port agencies and urban rail authority, and agreement on studies to implement action programs in the sector; and

(f) deregulation and privatization in areas of offshore storage/shipping facilities, containerization, tugboat service, and highway maintenance.

C. Potential Results

35. Action on the above areas would result in a more efficient and less costly transport operation in support of Argentina's export promotion efforts. At the same time, the negative effects on the overall public sector deficit will be significantly reduced.

RESTRUCTURING AND PRIVATIZATION

A. Analysis

36. Restructuring and privatization of public sector industrial enterprises provide a further means to help reduce the Government's financial burden and public sector deficits and to increase industrial efficiency, competitiveness and exports. These are important areas of policy consideration because future growth possibilities of the economy may hinge critically on the ability of the Government to keep down public sector deficits, which otherwise could lead to uncontrollable upward pressures on inflation, interest rates and/or taxes.

37. Policy objectives in restructuring and privatization should focus on: (a) restructuring of public sector enterprises which often have large potential for cost reductions or which, through their linkages, could have a significant impact on the efficiency and competitiveness of other parts of the industrial sector as well as the rest of the economy; and (b) privatization of select state-owned enterprises.

B. Policy Recommendations

38. Specific actions recommended include:

(a) technical, financial and organization/management restructuring of selected public enterprises or subsectors to improve the efficiency and competitiveness of basic industries. The most significant benefits from restructuring can be expected in steel (mainly SOMISA) and telecommunications (ENTEL). Systematic restructuring/rationalization should focus on improvements in: (i) organizational structures and management and administrative processes, including the degree of the enterprises' autonomy and the nature of their relationship with the Central Government; (ii) balancing and/or modernization of existing production lines; (iii) production management techniques (e.g., inventory and other working capital management, appropriate balance between production capacity and size and composition of work force; (iv) financing; and (v) pricing/cost recovery techniques;

(b) mounting a comprehensive program for privatizing public enterprises especially in the productive sectors (e.g., petrochemicals) which should include: (i) the identification of potential local and foreign private sector investors who would be interested in the purchase of state-owned assets; and (ii) the determination of vehicle of transfer of assets to private investors, e.g., stock market, international competitive bidding, etc.

C. Potential Results

39. Benefits of restructuring/privatization programs are likely to be significant for other productive subsectors through cost reductions and efficiency components, as well as through linkage and potential impacts on competitiveness. In the near term, the efforts toward privatization could

help reduce the public sector deficit and support the Government's stabilization objectives. In the longer term, through better exploitation of the benefits of private initiative and entrepreneurship, they could also lead to significant efficiency improvements in many segments of the economy, help stimulate direct foreign investment, and facilitate export development.

Table 1: ARGENTINA - Summary of Key Macroeconomic Aggregates, 1978-1985

(percentages)

	1978	1979	1980	1981	1982	1983	1984	Estimated 1985
GDP Growth Rate	-3.4	6.7	0.7	-6.2	-5.2	3.1	2.0	-3.0
Debt/Export Ratio 1/	1.62	2.0	2.5	3.1	4.6	4.8	4.7	4.7
Interest/Export Ratio 2/	1.69	14.6	20.4	33.0	51.6	56.8	55.8	50.6
Total Debt/GDP 3/	23	28	31	40	63	61	62	69
Interest Payments/GDP 4/	2.4	2.1	2.5	4.3	7.0	7.2	7.0	7.0
Debt Service Ratio 5/	38	24	31	43	65	71	64	61
Terms of Trade	78	83	94	107	92	88	93	89
Import Growth Rate 6/	-4.9	45.4	45.4	0.4	-41.2	-2.4	1.5	-5.3
Export Growth Rate	12.2	-3.0	-4.9	5.9	-2.4	11.5	-1.2	11.6
Current Account Balance	1,833	-537	-4,767	-4,714	-2,357	-2,461	-2,492	-1,280

1/ Total debt including short-term/exports goods and NFS; absolute ratio.
2/ Total interest payments to exports goods and NFS.
3/ Total debt including short-term/GDP.
4/ Total interest payments/GDP.
5/ Total interest and amortization on MLT divided by exports of goods and non factor services.
6/ Real growth rates in 1970 prices.

Table 2.A: ARGENTINA - Projections of Key Variables, 1985-1994, Base Case Scenario
(percentages and 1985 U. S. Dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP growth rate	-3.0	2.7	3.5	3.3	3.3	3.2	3.3	3.3	3.4	3.4
GDP/capita	2,049	2,066	2,101	2,131	2,163	2,194	2,225	2,257	2,292	2,328
Debt/Exports	4.8	5.0	5.0	4.5	4.1	3.7	3.3	3.3	2.8	2.5
Total Debt Outstanding and										
Disbursed (billions)	48.6	50.1	51.6	52.4	53.2	53.2	53.6	52.6	51.0	48.7
Debt/GDP)	69	69	69	68	66	64	62	59	55	50
Interest Payments/GDP	7	6	6	5	5	4	4	4	3	3
Debt Service ratio										
(exclud. short term)	61	67	50	44	43	42	43	39	39	38
Public Investment a/	2,451	2,426	2,523	2,624	2,729	2,839	2,952	3,070	3,193	3,321
Public Investment/GDP	4.9	4.8	4.8	4.8	4.8	4.9	4.9	5.0	5.0	5.0
Private Investment a/	3,827	4,264	4,596	4,964	5,356	5,774	6,207	6,672	7,173	7,711
Private Investment/GDP	7.7	8.4	8.7	9.1	9.5	9.9	10.3	10.8	11.2	11.6
Public Savings/GDP	6.9	7.9	8.2	8.8	9.0	9.3	9.6	10.0	10.2	10.5
Private Savings/GDP	12.2	10.6	11.1	10.9	11.1	11.1	11.1	11.1	11.2	11.4
Exports Growth Rate	11.6	-3.0	6.7	3.0	3.4	2.4	3.0	3.0	3.5	3.6
Exports/GDP	15.1	14.2	14.7	14.6	14.6	14.5	14.5	14.4	14.5	14.5
Imports Growth Rate	-5.3	4.8	3.8	3.7	3.7	3.7	4.0	4.0	4.1	4.1
Imports/GDP	8.6	8.8	8.9	8.9	8.9	9.0	9.0	9.1	9.1	9.2
Consumption/Capita										
Growth Rate	-5.2	1.5	0.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0
GNP Growth Rate	-2.8	3.3	4.0	4.1	3.6	3.7	3.8	3.6	3.7	3.8
GNP/Capita	1,898	1,926	1,967	2,012	2,048	2,086	2,128	2,165	2,206	2,249

a/ In thousand billions of 1984 pesos.

Notes:

1. Debt includes public and publicly guaranteed, private non-guaranteed and short term debt.
2. Exports and imports include that of goods and non-factor services.

Table 2.B: ARGENTINA - Projections of Key Variables, 1985-1994, High Case Scenario

(percentages and 1985 US dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP growth rate	-3.0	2.6	4.3	4.6	4.8	4.4	4.3	4.3	4.4	4.4
GDP/capita	2,049	2,066	2,117	2,176	2,241	2,297	2,355	2,412	2,474	2,537
Debt/Export	5.1	4.8	4.4	3.9	3.4	2.9	2.8	2.6	2.4	2.2
Total Debt Outstanding and Disbursed	48.6	50.1	51.9	52.5	52.6	53.2	53.9	54.3	54.8	55.2
Debt/GDP	69	65	60	54	48	42	38	34	29	25
Interest Payments/GDP	7	6	6	5	5	4	4	3	3	3
Debt Service Ratio (exclud. short term)	61	67	49	41	39	40	45	43	48	36
Public Investment a/	2,451	2,426	2,596	2,765	2,931	3,092	3,246	3,409	3,579	3,758
Public Investment/GDP	4.9	4.8	4.9	5.0	5.0	5.1	5.1	5.1	5.2	5.2
Private Investment a/	3,827	4,264	4,690	5,253	5,830	6,413	6,991	7,550	8,154	8,806
Private Investment/GDP	7.7	8.4	8.8	9.4	10.0	10.5	11.0	11.4	11.8	12.2
Public Savings/GDP	6.9	7.9	9.2	9.8	10.0	10.3	10.6	11.0	11.2	11.5
Private Savings/GDP	12.2	10.6	10.1	10.3	10.9	11.0	11.1	11.0	11.2	11.3
Exports Growth Rate	11.6	-3.0	8.6	6.3	6.7	4.1	4.6	4.3	5.2	5.1
Exports/GDP	15.1	14.2	14.8	15.0	15.3	15.3	15.3	15.3	15.4	15.5
Imports Growth Rate	-5.3	4.8	9.3	5.8	6.2	6.0	5.9	5.6	5.5	5.5
Imports/GDP	8.6	8.8	9.2	9.3	9.5	9.6	9.7	9.9	10.0	10.1
Consumption/Capita Growth Rate	-5.2	1.5	1.5	1.75	2.0	2.0	2.0	2.0	2.0	2.0
GNP Growth Rate	-2.8	3.3	4.9	5.6	5.2	4.9	5.0	4.7	4.8	4.8
GNP/Capita	1898	1925	1985	2059	2127	2193	2261	2324	2393	2464

a/ In thousand bullions of 1984 pesos.

Notes:

1. Debt includes public and publicly guaranteed, private non-guaranteed and short term debt.
2. Exports and imports include that of goods and non-factor services.

Table 3.A.1: ARGENTINA - Projections of Commitments, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	240	630	500	500	500	500	2,870
IDB (or other multilateral)	400	400	300	200	200	200	1,700
Bilateral Official Exp. Credit							
Suppliers' Credits	1,100	1,200	900	800	800	700	5,500
Commercial Banks	2,992	1,865	1,334	727	929	209	8056
TOTAL	4,732	4,165	3,034	2,227	2,229	1,409	18,056

Table 3.A.2: ARGENTINA - Projections of Disbursements, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	146	478	462	470	425	400	2,381
IBD	236	470	157	189	192	196	1,440
Bilateral/Official Exp. Credit							
Suppliers' Credits	695	826	375	375	325	275	2,871
Commercial Banks	2,992	1,865	1,334	727	929	209	8,056
TOTAL	4,069	3,639	2,328	1,761	1,871	1,080	14,748

Table 3.A.3: ARGENTINA - Projections of Repayments, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	116	149	161	159	178	198	961
IDB	76	100	35	50	68	118	447
Bilateral							
Official Exp. Credit	143	249	168	222	388	413	1,583
Suppliers' Credits							
Commercial Banks	765	982	—	—	—	466	2,213
TOTAL (including IMF)	1100	1480	364	431	634	1195	5204

Table 3.A.4: ARGENTINA - Projections of Net External Flows, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	30	329	301	311	247	202	1,420
IDB	160	370	122	139	124	78	993
IMF	702	400	-150	0	-300	-300	652
Bilateral							
Official Exp. Credit	552	577	207	153	-63	-138	1,288
Suppliers' Credits							
Commercial Banks	2,227	883	1,334	727	929	-257	5,843
Direct Foreign Investment (net)	214	246	285	330	384	447	1,906
TOTAL (incl. IMF and DFI)	3,885	2,805	2,399	1,660	1,321	32	12,102

Table 3.B.1: ARGENTINA - Projections of Commitments, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	240	630	800	900	900	900	4,370
IDB	400	400	500	500	500	500	2,800
Bilateral) Official Exp. Credit) Suppliers' Credits)	1,100	1,200	700	500	400	400	4,300
Commercial Banks	3,423	1,859	1,293	0	0	0	6,575
TOTAL	5,163	4,089	3,293	1,900	1,800	1,800	18,045

Table 3.B.2: ARGENTINA - Projections of Disbursements, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	146	478	600	670	670	600	3,164
IDB	236	470	157	189	192	196	1,440
Bilateral) Official Exp. Credit) Suppliers' Credits)	695	826	375	325	275	247	2,743
Commercial Banks	2,992	1,865	1,293	432	303	0	6,885
TOTAL	4,069	3,639	2,425	1,616	1,440	1,043	14,232

Table 3.B.3: ARGENTINA - Projections of Repayments, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	116	149	161	159	178	198	961
IDB	76	100	35	50	68	118	447
Bilateral) Official Exp. Credit) Suppliers' Credits)	143	249	168	222	388	413	1,583
Commercial Banks	765	982	0	0	0	805	2,552
TOTAL (including IMF)	1,100	1,480	364	431	634	1,534	5,543

Table 3.B.4: ARGENTINA - Projections of Net External Flows, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	30	329	439	511	492	402	2,203
IDB	160	370	122	139	124	78	993
IMF	702	400	-150	0	-350	-300	-602
Bilateral) Official Exp. Credit) Suppliers' Credits)	552	577	207	103	-113	-166	1,160
Commercial Banks	2,207	883	1,293	432	303	-805	4,333
Direct Foreign Investment (net)	269	214	246	285	330	384	1,728
TOTAL (including IMF and DFI)	3,940	2,773	2,457	1,470	1,136	-107	11,019

Table 4.1: ARGENTINA - Projections of Debt Outstanding and Disbursed, 1985-90: Base Case

(in millions of US dollars, end of period)

	1985	1986	1987	1988	1989	1990	Change 1984/1990
World Bank	579	985	1,286	1,597	1,844	2,046	1,420
IDB	1,104	1,465	1,587	1,726	1,850	1,928	993
IMF	1,800	2,200	2,350	2,350	2050	1750	652
Bilateral							
Official Exp. Credit	5,535	6,112	6,319	6,472	6,409	6,271	1,288
Suppliers' Credits							
Commercial Banks	35,860	37,174	38,391	39,118	40,047	39,790	5,843
Total Medium & Long Term DOD	44,878	47,936	49,933	51,263	52,200	51,785	10,196
Short Term Debt	5,005	4,500	4,000	3,500	3,004	3,175	-3,395
TOTAL	49,883	52,436	53,933	54,763	55,204	54,960	6,801

Table 4.2: ARGENTINA - Projections of Debt Outstanding and Disbursed by Source, 1985-90: High Case

(in millions of US dollars, end of period)

	1985	1986	1987	1988	1989	1990	Change 1984/1990
World Bank	579	985	1,424	1,935	2,427	2,829	2,203
IDB	1,104	1,465	1,587	1,726	1,850	1,928	993
IMF	1,800	2,200	2,310	2,310	2,050	1,750	652
Bilateral							
Official Exp. Credit) Suppliers' Credits)	5,535	6,112	6,319	6,422	6,309	6,143	1,160
Commercial Banks	35,860	37,174	38,350	38,782	39,085	38,280	4,333
Total Medium & Long Term DOD	44,878	47,936	50,030	51,175	51,721	50,930	9,341
Short Term Debt	5,005	4,500	4,000	3,500	3,165	3,383	-3,187
TOTAL	49,883	52,436	54,030	54,675	54,886	54,313	6,154

COUNTRY: ARGENTINA
FY86-FY90 PROPOSED LENDING PROGRAM - PROJECT DETAIL
NOVEMBER 27, 1985

High Case

MANAGING UNIT	PROJECT / STATUS		PLAN/ACT. APPRAISAL DEPARTURE	US$ Million BANK
FY86				
LC2PB	PA041-TAI-B	L	11/85	20.0
LCPWS	PA025-Water Supply-B	L	02/85	60.0
LCPAC	PA036-Agric. Sector-C	L	05/85	350.0
LCPEN	PA042-Power Eng.-B	M	11/85	10.0
	FY86 Totals: Lending Amount			440.0
	Number of Projects			3
FY87				
LCPT1	PA024-Bahia Blanca I-C	S	12/84	40.0
LC2PB	PA050-Trade Policy-C	L	06/86	350.0
EGYD2	PA047-Refinery Supp Ln-S	M	11/85	110.0
LCPI2	PA046-Sm. & Me. Ind. B	L	06/86	100.0
EGYD2	PA0 -Oil & Gas Private D	L	06/86	100.0
	FY87 Totals: Lending			700.0
	Number of Projects			4
FY88				
LCPI2	PA0 -Financial Sector D	S	06/86	350.0
LCPEN	PA051-Power Distrib. D	L	09/86	150.0
LCPI2	PA046-Export Promotion C	S	06/86	200.0
EGYD2	PA0-Gas Pipeline D	L	09/86	200.0
	FY88 Totals: Lending Amount			900.0
	Number of Projects			4
FY89				
LCPI2	PA027-Industrial Cr.III-D	S	03/87	150.0
LCPI2	PA0-Financial Sector II D	L	07/87	350.0
EGYD2	PA028-Oil & Gas Infrast.D	S	06/87	100.0
LCPI2	PA0 -Trade Policy II D	L	06/87	350.0
	FY89 Totals: Lending Amount			950.0
	Number of Projects			4
FY90				
INDD3	PA0 -SOMISA Restruct. -D	S	06/87	50.0
LCPEN	PA051-SEGBA V C	S	06/88	150.0
LCPWS	PA0 Water Supply D	L	06/89	80.0
LCPI2	PA053-Export Promot. II-D	S	06/88	100.0
LCPURB	PA0 Housing D	L	06/89	75.0
LCPURB	PA0 Market Town Impr.-D	L	05/88	75.0
LCPTR	PA0 Transp. Sector II-D	L	06/89	350.0
	FY90 Totals: Lending Amount			880.0
	Number of Projects			7
	TOTAL LENDING AMOUNT			3,870.0
	NUMBER OF PROJECTS			22

Reserve Projects:

FY87				
LCPAC	PA0 -Agric. Sector II C	L	09/86	350.0
FY88				
LCPTR	PA0 -Bahia Blanca II C	L	09/86	160.0
LCPEN	PA0 -Yacyreta C	L	09/86	200.0
FY89				
LCPTR	PA0 -Transport Sect. I-D	S	06/86	350.0
LCPI2	PA0 -Financial Restruc.D	L	06/87	100.0
FY90				
INDD4	PA055-ENTEL Restruct. -D	S	06/88	150.0

December 19, 1985

ARGENTINA: BAKER INITIATIVE COUNTRY STUDY

I. Initial Conditions

Economic Performance

1. Argentina's economy has been adversely affected by a poor political milieu and inappropriate economic management since the early 1950s. Over the last decade, abrupt shifts and inconsistencies in policies weakened Argentina's productive capacity and exacerbated structural imbalances. Economic mismanagement led to an increase of the country's external debt, which, as a share of GDP, has multiplied almost seven-fold (from 10% to 67%) during the last decade. Interest payments on the external debt now absorb about 40% of gross domestic savings compared to less than 5% in the early 1970s. While the external debt increased, domestic production declined. In 1985, real GDP per capita was 13% below its 1974 level. Investment declined to 13% of GDP, from an average of 21% during the early seventies.

2. The productive sectors, particularly manufacturing, are beset by thorny structural and financial problems. More than 40% of capacity in the construction industry now stands idle. Significant underutilization of capacity also exists in many manufacturing industries; and most firms also lack sufficient working capital. Financial intermediation is costly and inefficient, interest rates are high in real terms, and oversized banking institutions are suffering severe difficulties. Argentina's self-sufficiency in oil has deteriorated as the ratio of oil reserves to annual output has declined. Proven reserves of gas have increased, but the processing and transport infrastructure to exploit them is deficient.

3. Unfavorable changes in the external environment during 1979-82 further aggravated domestic problems. Argentina suffered external shocks equivalent to 4% of GNP owing primarily to deteriorating terms of trade and high interest rates. This situation was compounded by a deterioration in export competitiveness and a rapid increase in imports as the peso became increasingly overvalued. The policy response was primarily to resort to additional external borrowings. This was accompanied by some contraction of economic activity. The unfavorable external shocks and the poor policy response were further compounded by the South Atlantic war and subsequent political instability.

Stabilization Efforts

4. A democratic Government took office in 1983. The Alfonsin administration confronted a difficult situation: the economy was in poor shape following the 1982 military adventure, inflation was running at close to

20% per month, the fiscal deficit was about 16% of GDP, and the external debt exceeded US$45 billion. Nevertheless, most social groups greeted the new Government with strong expectations for an improvement in their living standards. The Government first used a gradualist approach to tackle Argentina's problems, but with little success. There was a modest gain in real output led by real wage increases but, in order to finance a seemingly chronic public sector deficit, the Government was obliged to resort to domestic financing, which produced a steady increase in inflation. The Government entered into a stand-by agreement with the Fund but was unable to meet the agreed targets. As the economy came perilously close to complete chaos, the Government changed gears and moved to shock treatment in mid-June 1985 with the Plan Austral and then reached agreement with the Fund on revised targets.

5. The Plan's main features were: (a) introduction of a temporary wage-price freeze to be supervised through spot-checks. However, before that a number of critical prices were adjusted. These included various public sector prices and an 18% devaluation; (b) a drastic cut in the overall public sector cash deficit, with the purpose of reducing it from 12.5% of GDP in the first half of 1985 to 2.5% in the second half of 1985. This was to be accomplished by increasing tax revenues, reducing real wages, and from falling interest payments resulting from lower inflation. The Government committed itself not to resort to Central Bank credit and to finance the deficit through capital inflows; and (c) a monetary reform introduced a new currency, the Austral, pegged to the U.S. dollar at a fixed rate.

6. The initial results have been impressive: monthly inflation has fallen from about 30% in May to 6% in June and about 2% per month on average during July-November; the overall public sector cash deficit has been cut down to slightly above 3% of GDP in the second half of 1985 without Government recourse to Central Bank credit; the deficit of the current account of the balance of payments has been reduced from 3.5% of GDP in 1984 to an estimated 2% of GDP in 1985. However, the stabilization program is encountering difficulties. First, the Government has been unsuccessful in containing the spending of some public enterprises and provincial governments. Unless additional measures are taken, the public sector deficit will exceed the Fund targets. Second, interest rates, although lower, now stand at 3% per month and discourage private investment. Third, the deficit in the current account of the balance of payments is expected to widen again in 1986, primarily because of continued deteriorating terms of trade and recent floods which have hampered agricultural production.

II. Objectives of the Medium-Term Program

7. In the design of a program for the medium-term recovery and development of the economy, it is important to recognize that the continuation of the Plan Austral is a necessary precondition for any program. Thus, even a base case scenario will require a continuing series of policy steps building upon and strengthening the program initiated in mid-1985. In laying out the scenarios for recovery and growth, two objectives have been established. First, that a modest but steady improvement in real per capita consumption is a necessity for the social and political maintenance of the consensus behind any economic program. Second, that the ratio of debt to exports must be brought down to levels where the normal role of foreign capital in the Argentine economy can be reestablished.

8. Real per capita consumption has been declining for some time and in 1985 was lower than any time in the past 15 years. With interest payments on foreign debt currently absorbing almost 40% of savings and 7% of GDP, it will be difficult to find much scope for improvements in real consumption. Nevertheless, the base case scenario explores the costs of providing a steady but very modest improvement of 0.75% per year, while the high case explores the possibilities of accelerating this to 2% within the next decade. On the external side, the objective is to reduce the burden of debt from its current high ratio of 5 times exports to more manageable, but still high levels of roughly 3 times exports by 1990, with the further objective of approaching ratios significantly below this during the following decade. Consistent with these two objectives, the base case indicates that Argentina should be able to achieve a 3% rate of growth of GDP while the high case implies rates in the range of 4-4 1/2%. Finally, it should be emphasized that the magnitude of the difficulties that the economy is currently experiencing is such that the differences between the base case--maintenance of the Plan Austral--and the high case--maximum effort--are fairly small in terms of results until 1989-90.

SVP note on objectives

III. Implications of the Objectives of the Medium-Term Program

9. In assessing the implications of the objectives of the medium-term program, two key structural characteristics of the economy must be explicitly recognized. First, the economy is a relatively mature one with relatively small increases in population and labor force which, over the past half century, it has never exhibited the high growth rates characteristic of more normal developing countries. Thus, it would be unrealistic to expect growth rates of GDP to exceed 5% over a sustained period, even under conditions of maximum policy efforts. The second factor is the immense size of the external debt, equivalent to two-thirds of GDP and five times the size of exports. Even under the Plan Austral the economy does not generate enough surplus on the balance of payments to cover the interest on its debt. Thus, any program, even under the best of policy conditions, will require net lending to Argentina (either as fresh money or as capitalization of interest) for at least the next 2-3 years.

10. It is also important to point out that in our judgement it is necessary that the Plan Austral, in itself a bold and significant policy effort, be maintained. Thus, we have taken this as our base case rather than setting forth the very dismal scenario that would emerge if we were to extrapolate the performance of the 1980-84 period, which would involve a stagnation in real growth, a continued decline in real per capita consumption, a highly protected and inefficient domestic economy, continued high debt to export ratios, and, in all likelihood, continued political instability. Thus, there is perhaps a less striking difference between our base and high cases than in other countries where similar analyses have been made.

11. Investment in Argentina has in recent years been an extremely low share (13%) of GDP and has been characterized by inefficiency with high ICORs. The program for the future does not call for massive new investments across the board, but rather selective investment in key areas, both public and private, with a focus on increased efficiency. Thus, it is projected that in the base case investment might productively be increased to

15% of GDP by 1990 and 17% by 1995 with private sector investment (currently 60% of the total) increasing twice as fast as public. In the high case, the ratios to GDP are only slightly higher (16% and 19%) but the ICORs are significantly lower as policy reforms, for example in the energy sector, are implemented allowing a significantly more efficient use of capital stock.

12. Roughly 40% of domestic savings is now being used to pay interest on external debt. Even under the best of policies it is not likely that this can be reduced to less than 20% before 1990. Saving itself, under either scenario, should show a modest improvement in its share of GDP in response to measures to reduce the public sector deficit and encourage private sector savings. The latter could be supported by the financial sector reform as well as by the improved investment climate generated by the policy package.

13. The exchange rate established in the June 1985 measures represented a more than competitive parity for the Austral. While there has been a modest domestic inflation since that time, the currency has not, in the opinion of the IMF, yet moved to a non-competitive position. It is expected, however, that during the period covered by our projection, the authorities will take the required policy measures, including--if necessary--periodic adjustments of the exchange rate in order to maintain the approximate competitiveness of the currency that existed during the latter half of 1985.

14. The key to Argentina's recovery and to the reduction of the heavy debt burden is the performance in the export sector. This is made all the more difficult by the relatively small degree of openness of the economy; exports are currently only 14% of GDP. In addition, the current weak position of the commodities that make up most of Argentina's exports does not augur well for rapid improvements in earnings in the short-run, even with maximum productive efforts by the country itself. Given that beef, wheat, soybeans, and sorghum are key commodities, it is unlikely that after 1985-86 improvement in production there will be more than 2-3% long real growth in exports. In the high case, full implementation of our policy recommendations in agriculture, trade, and more importantly in the energy sector, could result in real growth of exports in the 5% range.

15. On the import side the projections imply a relatively unchanged share of GDP given a competitive exchange rate. This reflects the fact that tariff levels in Argentina are relatively low already and are unlikely to fall significantly in the near future (see para. 41). Under the base case, because of the necessity to have a modest improvement in per capita consumption, total external debt rises until 1991; in the high case this peak takes place in 1989. In the high case, the projection also assumes that there will need to be an acceleration of the value of capital goods imports, reflecting a capital deepening.

16. External debt, including short term, is currently just under US$50 billion. The debt service ratio is currently over 100% of exports. Not only does this debt present a serious impediment to the resumption of normal international financial relations for Argentina, but it also represents a heavy burden on domestic resource mobilization. At the present time, the interest payments on all of Argentina's debt are over

US$5 billion, while the resource surplus on the trade account is only slightly above US$3 billion. Thus, not only must exports grow, but but efforts need to be made to reduce the relative size of the debt in relation to the economy. The implication of the current situation is that as there is an insufficient resource surplus to pay interest on the debt at least for the next two to three years, Argentina will have to arrange for lending to cover this requirement. Reschedulings, whether officially or de facto, will be required throughout the rest of the 1980s with the possibility of some potential for repayment of commercial bank lending during the 1990s.

17. The projections are based on the assumption that all debt to commercial banks as of the end of 1985 is serviced on interest with amortization being fully rolled over, and all other debt is fully serviced including all new debt from commercial banks. When the projections reach the point that all such payments can be made without fresh borrowing, the surplus is assumed to accumulate in reserves. At that point four choices will be available to the Argentine authorities by 1994 in the base case and by 1990 in the high case to: (i) repay principal on pre-1986 commercial bank borrowing; (ii) increase imports with a view to accelerating growth; (iii) increase imports so as to improve consumption levels; and (iv) accumulate foreign exchange reserves and earn interest on them. There is no clear-cut case for preferring any one of these alternatives. It is quite probable that increased investment in the Argentine economy, beyond the point where growth is in the 4-4 1/2% range, would not increase growth further, but rather lead only to increased inefficiency in the use of capital. Repaying the principal of the pre-1986 commercial bank debt is certainly possible, but would only be desirable if it would enhance Argentina's creditworthiness. Increasing reserves is not an end in itself, it simply increases the resources available to be spent and the temptation to spend them on large projects. Finally, the authorities could certainly use the resources to increase consumption even earlier than projected, which while certainly attractive, could lead to increased inflationary pressures on the non-tradeable sectors of the economy. Clearly, the authorities, when the time comes, will utilize a mix of the four alternatives; the point is that this should be done in a careful and balanced fashion. The purpose of the present exercise is to indicate at what point in time such an option might be available rather than to specify exactly what choices should be made. Thus, the choice of accumulating reserves has been adopted in our projections on a purely notional basis.

18. In recent years, Argentina has been characterized by high fiscal deficits and, as stabilization was set in place, by very low ratios of money to GDP--M1 to GDP was as low as 3% and will probably finish 1985 at about 6%. The dilemma facing the authorities is how to increase the availability of money in the economy without raising inflationary pressures. Accordingly, the money expansion must be very modest and in both scenarios we have assumed that the policy packages are consistent with an expansion of the money to GDP ratio to 10% of GDP over the next four years. The fiscal deficit will be very difficult to reduce over the short run given the high debt servicing burden placed on public finances and the structural problems in state enterprises, particularly YPF (Yacimientos Petroliferos Fiscales). We have thus assumed that the deficit can be reduced to 3% of GDP during 1986, but that in the base case it will fall no further. In the high case the policy reforms, particularly in YPF, should allow a further

drop to 2% of GDP, but this, we believe, is the long run structural ratio of the deficit.

IV. Policies, Institutions, and Priorities

19. Argentina has the potential to reverse the current recessionary trends in economic activity and gradually achieve respectable growth rates while reducing its debt exports ratio. Fulfillment of this potential in a high case scenario is predicated on the adoption of comprehensive policy reforms.

20. In a first stage, the Government has put into place a comprehensive program to stabilize prices, reduce the fiscal deficit and strengthen the external accounts. The next hurdle that needs to be overcome is the transition from a wage and price freeze to a regime of price flexibility. To proceed on this course without once again destabilizing the economy, the Government needs to undertake measures which should permanently reduce the fiscal deficit and avoid using Central Bank credit to finance it, so as to create an environment for breaking medium-term inflationary expectations as it implements a concerted and gradual phasing out of the freeze.

21. The Government has stated its intention to address the root causes of Argentina's economic woes through comprehensive medium-term program of structural reforms. At the moment though it is still seeking its way, the elements for an integrated program have not yet been put together. It is considering to eliminate most quantitative restrictions on imports and replace them by tariffs. It is also planning to reduce state participation in the industrial and petroleum sectors. Further, it has indicated interest in Bank support for the privatization of its petrochemical holdings in the Fabricaciones Militares complex. However, the Government is moving only slowly in opening up petroleum exploration and exploitation for the private sector; likewise, in telecommunications, it has decided to entrust the expansion of the seriously defective telephone network to a public sector company (ENTEL) that has been unable to operate the existing systems satisfactorily. The Government needs to act on several fronts simultaneously: improve the incentive system for the private sector, define a policy for the public sector, streamline public expenditures, eliminate distortions in the financial sector, and strengthen the infrastructure required to support exports. The following paragraphs summarize our judgment on the relative importance of the policies and measures required to achieve the objectives mentioned above.

22. The Government should give first priority to eliminating export taxes and quantitative import restrictions. As of October 1984, the average import tariff was about 23%. A comprehensive trade policy reform, including lower rates of effective protection only seems feasible once the economic recovery is well under way. Meanwhile, a gradual process of rationalizing the trade regime should support a concerted major drive to promote industrial exports. We have estimated that such a program, which could be supported by Agricultural Sector, Trade Policy and Export Promotion Loans, could generate incremental foreign exchange earnings of about US$1.2 billion from agricultural exports and of US$1.3 billion from industrial exports by 1990; however, this would require new offsetting fiscal measures.

23. Policy reforms in oil and gas are crucial for the high case scenario to materialize. The Government has indicated its intention to allow for a broader role of the private sector, both foreign and local, in the development of Argentina's hydrocarbon resources. However, it has been slow in defining specifics and in taking concrete action. Key among the requirements for the promotion of gas and oil developments are more attractive and stable incentives for the private sector, award of attractive new exploration and exploitation contracts, limitation or elimination of convertibility risk, access to domestic credit (i.e., "apex" financing arrangements) and rationalization of the price structure of hydrocarbon products in line with economic costs.There are also possibilities to enhance the participation of the private sector in the gas transportation and distribution system. We have estimated that Argentina has the potential to export around 70,000-120,000 barrels per day amounting to US$0.6 to US$1.0 billion of crude oil/petroleum (at US$24 per barrel) products by 1990. At the same time YPF is the single major source of the public sector deficit. Moreover, annual investment requirements during 1986-90 of about US$1 billion for petroleum and US$0.5 billion for gas cannot be met by the public companies. Bank lending in support of rational hydrocarbon development policies could include Refinery, Supplemental Oil an Gas Sector (policy-based) and Oil and Gas Private (project financing) Loans.

24. Eliminating the existing distortions which do not allow capital markets to operate efficiently will be a key to stimulating investment for capacity expansion. However, because of the risks of a financial crisis involved in a comprehensive financial sector reform, the needed reform has to proceed in stages. First, real interest rates could be reduced sharply by removing present surcharges, shifting the burden of reserve requirements to sight deposits with very low requirements on time deposits, and reduce controls to direct credit. Second, the Government should initiate a program to restructure the sector through mergers and acquisitions by means of increasing minimum capitalization requirements and temporary fiscal measures to promote consolidation. However, the Government needs to proceed with caution, perhaps first concentrating on public banks that are inefficient. A proposed Financial Sector Reform Loan has tentatively been included in our program.

25. A framework for reforming the public sector should include the medium-term role of the public sector in the productive areas; namely, to both restructure and privatize public sector enterprises. Moreover, its share of public sector investment in total investment should gradually decrease. The public sector should not have preferential access to credit. Budgetary policy should be such that only transfers for equity take place and that operating losses of enterprises not be financed by either the Central Bank or the budget. At the same time, the public sector should have freedom to set its prices within certain regulatory limits for monopolistic services. Finally, enterprises should be managed as commercial entities, including policies over wages, recruitment and dismissals. A proposed Technical Assistance Loan would assist in formulating the above framework.

26. In the context of implementing the reform of the public sector, the Government also has to place emphasis on reorganizing its own house. The thrust of this effort should be to reduce public sector employment

(through attrition) and to improve the efficiency of public sector enterprises including adequate cost recovery policies. Analytical work to improve the efficiency of public enterprises [especially YPF, ENTEL, Railways, SOMISA (steel)] has been initiated. Preliminary results indicate that restructuring of these enterprises could lead to major gains in their efficiency and competitiveness, while at the same time strengthening public sector finances. The Bank could support restructuring, which would be a lengthy and difficult endeavor through sector loans in transport, energy and enterprise specific loans for SOMISA and ENTEL.

27. Similarly, the Government will need to prepare and review carefully the priorities of a medium-term public investment program. Our recent review of a preliminary investment program has indicated the following priorities in the transport and energy sectors, which account for about half of public sector investment: (i) improvement of port services; (ii) reconstruction/maintenance/graveling of high-trafic roads; building of feeder roads for the main export corridors; (iii) enhanced oil recovery/ liquid extraction and gas gathering projects, acceleration of oil and gas pipeline construction; (iv) reinforcement of power transmission/distribution lines. The Government has to strike a better balance between new investment and maintenance; to introduce uniform investment criteria; define priority projects; and establish a central review for all public investment projects. In this connection, a central project processing/monitoring unit would go a long way in helping to implement the criteria and investment priorities that are agreed upon. As regards investment financing, improvements in tax administration and rationalization of public tariffs should be undertaken simultaneously with the elimination of earmarked funding (special funds) which are not conducive to efficient resource allocation. The Bank could support government efforts in this context through Technical Assistance, Bahia Blanca Ports I/II, Yacyreta supplemental, Power Distribution and Transport Sector Loans.

V. Annual Action Programs

28. The policy reform proposals included in the high case scenario should be implemented on the basis of annual action programs. This section outlines in detail the annual action program for 1986. The annual action programs for 1987-90 are outlined in the attached Policy Matrix (Annex I) These of course would be reviewed and modified to take into account the results of the implementation of each annual action program and changes in the external environment. Discussion of the policy requirements under the base and high case scenarios for 1986-90 is included in Section VI below.

1986 Action Program

29. The 1986 program would focus on: (a) agreement on a medium-term macroeconomic program; (b) preparation of a medium-term public sector investment and financing plan and external borrowing programs; (c) adoption of revenue and expenditure measures required to meet the targets under the Government's stabilization program; (d) phase-out of the wage and price freeze; (e) exchange rate measures to maintain Argentina's international competitiveness as required; (f) improvement of the effective exchange rate

What about X favours if thats high priority?

in agriculture; (g) elimination of import prohibitions and quantitative restrictions; (h) improving the administrative mechanisms of trade management; (i) extend financing for exports; (j) initiate support of export services as part of export promotion; (k) initiate reforms in the financial sector, and (l) introduce measures which will produce a structural reform in the operation of enterprises in the energy sector. More specifically, this would require the implementation of a number of sectoral actions.

30. Agriculture: (i) removal of the temporary increases in export taxes imposed in June 1985 (see para. 33 for offsetting revenues); (ii) removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985 and redesignation of tractors and agricultural machinery from the "prohibited" to the "free" classification for imported goods; and (v) initiation of studies to promote exports and improve efficiency in the sector.

31. Trade: (i) import liberalization through the elimination of most import licensing requirements: (a) reclassification of about 50% (2,000) tariff positions from prohibited to free and partial replacement by tariffs; and (b) reclassification of about 50% (650) tariff positions from prior consultation to free and partial replacement by tariffs; (ii) achievement of free trade status for export industries, through the reform of the temporary admission regime for imported inputs, along the following lines: (a) simplification of administrative procedures; (b) guarantee of automatic access for any products; (c) coverage of indirect exporters; (d) extension to capital goods used for export production; and (e) extension of the tax reimbursement scheme to exports processed under the temporary admission regime; (iii) simplification of export procedures, eliminating all unnecessry interventions by public sector agencies; and (iv) preparation of terms of reference for studies needed to support the adjustment process: (a) study of tariff protection with a view to actions that will reduce tariff dispersion; and (b) study on the indirect tax content of exports, with a view to actions to rationalize the system of tax rebates to exports, as well as strengthening it vis-a-vis trading partners that might be tempted to impose countervailing duties; (v) removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; (vi) facilitate joint financing by banks; and (vii) develop a common data base for exporters.

32. Financial System: (i) lowering reserve requirements; and (ii) preparing a program for rebuilding of the financial sector.

Public Sector

33. Fiscal System: (i) identification of alternative sources of fiscal revenues and taking appropriate measures as needed to maintain the fiscal deficit at levels commensurate with the ceilings of the Government's stabilization program; (ii) satisfactory progress on a program for preparation and implementation of federal land tax; and (iii) tax administration: (a) initiate the improvement of information flow by unification of taxpayer identification for each separate tax collecting entity; phase out expensive visit system in favor of distribution of information on cross-compliance; increase penalities for evasion; and concentrate audit efforts on VAT; (b) eliminate tax amnesties; and (c) focus excise tax collection on commodities where the Government has direct control over the collection.

34. Public Enterprises: (i) decision to restructure and privatize; (ii) initiate reduction of employment through attrition; (iii) introduce managerial accountability and cost accounting; (iv) initiate real tariff increases in electricity and water supply enterprises; (v) minimize coal investments; (vi) postpone major hydroelectric projects; (vii) cancel the expansion of the petrochemical production capacity in Bahia Blanca, of the SOMISA new sheet steel rolling mill and the shipyards expansion; and (viii) establish clear criteria for public enterprise management on a commercial basis.

35. Energy: (i) reduction of YPF budget deficit (from projected US$1.1 billion to US$0.4 million): (a) investment program. Cut proposed program of US$1 billion to US$600 million by reducing exploration and production activity from a proposed 130 exploration and 850 production wells to 50 exploration and 250 production wells, focussing on high-yielding fields and secondary recovery projects making maximum use of existing shut-in wells and well repairs. New oil production contracts with private companies would supplement YPF's production efforts. Continue infrastructure investment, mainly refinery conversion, which should be completed on time and could not be farmed out to the private sector at this stage; (b) operating budget. Establish action plan to achieve operating cost reductions estimated at about US$0.3 billion through savings due to reduced drilling activity (US$0.2 billion) and efficiency improvements (US$0.1 billion); and (c) monitoring mechanism. Establish independent monitoring body reporting to the Ministry of Economy which supervises YPF's budget programs on a continuous base and approves/countersigns major decisions/expenditures; (ii) private sector oil exploration and production: (a) new private oil production contracts. Establish action plan to farm out explored areas to local and foreign oil companies under production contracts. Achievable private sector investment estimated at US$200-300 million annually; (b) private oil exploration contracts. Complete first bidding round for 32 areas (of 164 already defined areas) for new risk contracts by February 1986. Complete second round for another 30 areas during 1986. Estimated investment possibilities: about US$200 million annually once drilling phase of awarded contracts starts; and (c) financing of private sector operations. Allow export of crude oil or petroleum products for limited recourse financing schemes. Improve disbursement procedures for World Bank funds managed by BANADE. Utilize IFC funds as matching funds to mobilize additional on-lending loans from commercial banks; (iii) YPF organization improvement: (a) Establish action plan to implement accounting and financial management systems to allow cost control by activity and clarify accountability of YPF managers; and (b) institute a high-level government committee to prepare options and approaches to restructure YPF and to introduce workable competition in the petroleum sector; (iv) gas sector: (a) begin Northern Pipeline expansion with clear schedules and budget provisions; (b) prepare transmission pipeline expansion program (Central West and new Western Pipeline); (c) resolve the COGASCO dispute in 1986; and (d) introduce new financing schemes such as limited resource financing guaranteed by petroleum export revenues; and (v) power sector: initiate real tariff increases.

VI. Scenarios

36. This section is a description of the type of evolution of the economy that we expect to see under the two different policy scenarios. The differences in the scenarios are essentially a matter of degree in timing and intensity of implementation of policy reforms, which would condition, again as a matter of degree, a return of confidence and, consequently, direct private investment (both domestic and foreign). As was pointed out earlier, the base case requires the maintenance of the Plan Austral and thus needs a significant degree of continued policy action on the part of the authorities. As noted, a true base case would imply a return to the chaotic and disastrous policies of the early 1980's and would be characterized by escalating debt, high inflation, declining per capita consumption, and stagnant GDP. The Plan Austral represents a bold repudiation of these policies on the part of the Argentine people and an implicit assertion that the Plan, even with its present and future sacrifices represents a minimum acceptable state of the economy.

37. The central sequence of policy actions and responses in the economy centers on the necessity at first on increasing exports as rapidly as possible so as to address the overriding balance of payments and debt constraints. Thus the policies in the immediate future are aimed at exportables and at the incentives to export. As the economy has a moderate degree of unutilized capacity in most sectors, the initial thrust will be on pricing. To this end the agriculture policies are directed at a reduction in export taxes and a reformation of credit policies. Similarly in the manufacturing sector where trade policy reform is an early priority. In both these sectors there is enough capacity that it will be several years before new investments need come on stream. In order to effect this however, it will be necessary for a reform of the financial sector to have taken place, ideally by early 1987, so as to lower the real cost of capital to investors while simultaneously increasing the incentives to savers. A second key to the recovery will be the oil and gas sector. Here the country has a substantial potential, not only for natural gas, but also for petroleum. In the short-run the issues can best be addressed by the encouragement of the private sector in the industry, by allowing the private sector into the exploration and development phases, by reducing part of YPF's investment program (drilling and exploitation) and giving the private sector the responsibility to undertake it, and by encouraging technical developments in the extraction of existing wells. Finally, there are issues that affect the fiscal strength of the country including an early start on attaining adequate pricing in natural gas, power, and water and sewerage, improved planning, the scaling down of the public investment program, and monitoring of public sector investment. This latter program should not only be aimed at allowing the private sector greater participation in productive sectors, but also in focussing the investment of the public sector in key infrastructural areas (such as ports and transport corridors).

38. In the high case scenario, a very significant policy measure concerns the building of gas pipelines and this requires an early settlement of the COGASCO issue. This policy initiative will allow a dramatic

change in the energy accounts of the balance of payments, by allowing the gas associated with petroleum deposits to be taken off and thus allowing a substantial increase in petroleum output. In addition this scenario will require high levels of private investment in the sector. In both cases, it would be necessary to improve extraction from existing wells, private sector participation in exploration and development and moderate private sector investment. In the agricultural sector, while the base case would only envision export taxes being dropped to the May 1985 level, the high case would phase out most of them and would focus on public investment in the transport infrastructure between the producing areas and the ports. In the trade field, the base case will require policy actions. The high case may require further improvements in the competitiveness of the exchange rate, but will certainly require coherent and stepped-up efforts on export promotion. In the base case scenario, adequate pricing policies will be requiredin the power sector. In the high case scenario, the power sector will require expanding the transmission and distribution network and the timely completion of ongoing power generation projects (including Yacyreta) based on adequately projected demand requirements. Finally the distinguishing characteristic of the high case scenario will be the expanded and enhanced role that the private sector must play in the economy. Private investment must double in real terms within the next seven years. This can only take place with a coherent and productive environment for the private sector coupled with an efficient financial system.

VII. Difficulties in Implementing Policy Reform

39. The proposed policy reform program outlined in the preceding sections constitutes a major task. With the exception of privatization, the proposed policy reforms in the agriculture, trade, energy and financial sectors are necessary for the high case scenario to become viable.

40. The reform of agricultural sector policies will be criticized by the conservative agricultural producers who are dead set against a land tax. Within the Government, at a time of great fiscal stringency, the Secretary of the Treasury is justifiable uneasy about the elimination of taxes that are very easy to collect (export taxes) and their replacement by a new tax that may prove harder to collect (the land tax).

41. Trade policy reform is an extremely sensitive area. The previous import liberalization attempt was a bitter disappointment: entire industries disappeared, industrial employment declined in absolute terms, and small and medium scale industries were particularly hard-hit; and the country had nothing to show for it. Thus, any effort perceived as reviving the "Martinez de Hoz policies" would be doomed to failure now. For this reason, the proposed program of policy reforms focuses on achieving free trade status for export industries, shying away from a comprehensive tariff reform that would decrease the already low average effective protection and its dispersion. This would be a way of maintaining the dialogue open on an issue whose sensitivity might diminish in a few years. Proceeding differently--that is to say, raising the issue of decreases in average effective protection at this point--would be extremely counterproductive. Business

and labour leaders would present a united opposition front. The better investment climate that the Government is painfully trying to reconstruct would deteriorate sharply and the Bank's policy dialogue would be seriously jeopardized. Yet it must be recognized that so long as the import regime remains restrictive, additional external financing under the Baker proposal or repatriation of Argentine assets now held abroad might have inflationary consequences.

42. The major reforms proposed in the energy sector are likely to provoke opposition from several sectors. Drilling contractors which now execute about half of YPF's annual drilling program, will vehemently oppose any cuts that jeopardize their service contracts. This would be supported by provincial governments in oil-rich areas if reduced state production activity resulted in a loss of royalty payments and reduced employment of workers in the oil service industries. These concerns could be addressed by awarding a substantial amount of production contracts to private sector firms, which would shift risk and financing burdens to the private sector. In particular, foreign firms would be able to service capital more easily and could improve production efficiency more quickly than local firms. Moreover, any privatization of oil production, introduction of more competition or the restructuring of YPF, are likely to encounter resistance from YPF's management, unions, and political forces within the Radical Party (traditionally supporting public sector dominance of oil and gas activity). This could be addressed by the creation of new private sector jobs through the increase in private sector activity and by improving performance incentives within YPF. Basically, however, these groups will have to be convinced that the proposed policy reforms will improve the Government's fiscal deficit and the balance of payments prospects.

43. Financial sector reform is likely to be resisted by the owners and managers of those financial institutions that are least likely to survive. Since restructuring will unavoidably imply the closing down of some institutions and branches, it must be expected that, the banks' employees unions will agitate to defend their members' jobs. Pressure will be applied on the Government to absorb the redundant employees (about 30,000) which it will not be in a position to employ.

44. Privatization efforts in all sectors are likely to be resisted, even by some groups within the Radical Party. The issue is complicated, moreover, by the administration's reluctance to antagonize the armed forces unduly, and the fact that some of the more obvious privatization cases are the Defense Ministry's steel and petrochemicals industries. Even in the event that privatization could take place, the availability of buyers and lack of financing could pose a serious constraint to divestiture.

VIII. Monitoring of Policies

45. The Bank would follow the Colombian model to monitor the progress of the Government's medium-term program. Such monitoring would be implemented through yearly assessments of a medium-term macroeconomic and public sector investment programs. This would include the adoption and direction of policies to ensure the programs' future viability. Consideration of

policy based loans which would include specific agreements on agricultural,trade, energy and financial sector policies and public sector reforms, and on a successful implementation of the above mentioned programs. We would push to reach an agreement with the Government on the above before we present a proposed Trade Policy Loan to the Board. We would also include in the programs specific agreements on the adjustments of prices of public utilities to appropriate levels, together with corrective actions on the overall economic program as required, and actions to increase the role of the private versus the public sector, including foreign investment. On the basis of the above, we would undertake regular supervisional exchange of views with the Government. The Bank's yearly assessment of the macroeconomic program would take into account the IMF's review of its stand-by agreement with the country, particularly as it relates to targets on net international reserves, the fiscal deficit, total credit of the Central Bank, net credit of the Central Bank to the public sector and the level of public sector debt on a quarterly basis. The Bank's overall assessment would incorporate the IMF's view on progress with respect to achieving and maintaining export competitiveness in the current stand-by, and in subsequent ones, to be negotiated once the current one expires in March, 1986. As part of this process, we will propose to the Government that it prepare and send to the Bank two reports on a yearly basis, summarizing the status of implementation of the medium-term program to be agreed with the Government. The first status report would also serve as a basis for a mid-term review. These reviews would also form the basis for the release of the tranching under new policy based lending.

IX. Stabilization: Relationship with the IMF

46. The principal aim of our relationship with the Fund will be to develop an operationally effective understanding before their next stand-by negotiation (March 1986). The purpose of the proposed relationship will be to: (a) agree on a medium-term framework necessary for the country to become creditworthy and resume real economic growth; (b) agree on a stabilization approach that is compatible with growth objectives; (c) receive their input and support to ensure that the Government's medium-term investment program will be financially viable; (d) define the respective roles in monitoring; and (e) incorporate the IMF's view in progress with respect to stabilization and maintenance of export competitiveness in the Bank's overall assessment of the adequacy of the Government's medium-term macroeconomic program. Consistency between short-term stabilization and medium-term growth will be essential. The IMF would be responsible for the stabilization aspects of the medium-term program; the Bank would be responsible for the growth and efficiency aspects (Section VIII above). Continuous consultations would take place to ensure that stabilization and growth objectives are compatible with each other. In this connection, Fund/Bank consultations would also focus on the stabilization issues to be covered by Fund missions and on the issues which Bank economic missions and policy based lending operations would cover. The Fund's expertise in the fiscal area would be sought to complement our analyses regarding the introduction of new taxes in our policy based lending and for the supervision of the tax policy and tax administration activities in the proposed Technical Assistance Loan.

X. Financing Requirements

47. Given the above objectives, policies, and constraints, it is estimated that between 1985 and 1990, even with the best achievable policy package, the Argentine economy will require net flows (excluding IMF and direct foreign investment) of some US$9 billion, the bulk of which would have to be concentrated in the 1985-87 period. With the more modest policy package the flows would be more in the range of US$11 billion. It is envisioned that this would require gross disbursements of about US$16 billion and commitments of a similar magnitude in either case. The Argentine economy itself has not been characterized as one with large trade deficits. The country's indebtedness increased during 1979-82, mainly because of a misguided policy experiment which was followed by a huge capital flight and because of an unfortunate military action. For this reason Argentina may develop the capability to repay its external debt if policies appropriate to fully utilize the country's potential are implemented, provided the Government does not opt for substantially higher consumption levels. In the base case, longer maturities for fresh money from the commercial banks would be required as compared with the high case where such borrowings could be repaid over a shorter period of time. In the base case, some 60% of the net flows would have to come from the commercial banks, concentrated mainly in the early years of the program. In the high case, the commercial banks' share would be somewhat lower as the potential to service the debt fully would appear sooner (1988 as compared the base case (1990). World Bank commitments for 1986 would amount to about US$630 million in both cases, since the level of commitments would be significantly firmed-up. From 1987 onwards, commitments would average US$500 million per year in the base case; and in the high case, US$800 million in 1987 and US$900 million per year during 1988-90. In the base case the World Bank share would be just under 20%, while in the high case, the World Bank share would go up as the need for new commercial bank lending diminishes. Finally, if higher consumption levels than those projected in the above analysis are politically necessary, then the external resource requirements to effect full recovery would be higher.

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ARGENTINA - PROPOSED MEDIUM-TERM ADJUSTMENT AND GROWTH PROGRAM

High-Case Scenario

Main Goals: (1) To restore and sustain real economic growth of 4% on average during 1986-90, and 4.4% during 1991-95.

(2) To expand exports in real terms by 5.4% on average during 1986-90.

(3) To maintain a sound balance of payments position, consistent with a reduction in the debt to exports ratio from 5% in 1985 to 3% in 1990.

Note: * indicates actions to be implemented in one year; —— indicates actions covering several years.

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
A. TRADE, INDUSTRY AND AGRICULTURE								
1. Exchange Rate Policy	Maintain international competitiveness	Crawling peg devaluations during first half of 1985; 18% devaluation in June 1985; continuing depreciation of the real exchange rate vis-a-vis major trade partners	Maintenance of competitive exchange rate policy through periodic adjustments which are equal to the difference between domestic and international inflation.	——	——	——	——	——
	Improve the effective exchange rate in agriculture	Export tax on wheat reduced from 26.5% to 15% (September 1985); smaller reductions in other commodities	Phased reduction of export taxes on agricultural commodities by 1988 to no more than 50% of the rate in force on May 1,1985, and by 1990 to 5% of agricultural exports	——	——	——	——	——
	Improve the effective exchange rate in industry	Export taxes on agroindustrial exports eliminated (August 1985)	Full rebates on direct and indirect taxes paid by exporters.		*			
2. Import/Export Regime	Eliminate prohibitions and quantitative restrictions		Phased elimination of most import licensing requirements: (i) reclassification of 4,000 (100%) tariff positions from prohibited to free list and partial replacement by tariffs	——	——			
			(ii) reclassification of 1,300 (100%) tariff positions from prior approval to free list and partial replacement by tariffs	——	——			
			(iii) redesignation of tractors and agricultural machinery from the prohibited to free list.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
3. Export Incentives	Provide inputs for exporters at world prices Reduction of import tariffs Improve the administrative mechanism of trade management Provide export support services and adequate and timely information		Reform of the temporary admission regime for imported inputs: (i) guarantee of automatic access to any input;	*				
			(ii) gradual coverage of first-line suppliers of exporters;		*			
			(iii) gradual extension to capital goods used for export production.		*			
			Removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985.	*				
			Preparation of studies needed (i) to rationalize the import tariff structure	—	—			
			(ii) to rationalize the structure of tax rebates for exports.	—	—			
			Implementation of recomendations of above studies				—	—
			Simplification of export procedures, unification of agencies authorized to review and approve export applications.	—	—			
			Formation of a joint organization to provide institu tional support for marketing, storage, quality guarantee, legal assistance, lobby. Development of an integrated data base.	—	—	—		
4. Export Financing	Expand available resources		Removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; and encouragement of joint financing by banks.	*				
			Review the level of financing subsidies.				—	—

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Allowance of export plans by firms as a basis to determine the amount of Central Bank credit lines for financing.		*			
			Broadening risk coverage of exporting firms.		*			
5. Agricultural marketing	Provide marketing infrastructure		Provision of market places and information for non-traditional agricultural products.		—	—		
	Expand transport and storage facilities		Promotion of private sector participation.		—	—		
B. FINANCIAL SYSTEM								
1. Interest Rates	Reduce real costs of financing for investments		Lowering reserve requirements on time deposits and sight deposits.	—	—			
2. Sector Restructuring	Create a healthier financial sector		Increasing minimum capital requirements for financial institutions		—			
			Temporary stock purchasing to facilitate adjustment and consolidation		—	—	—	—
			Institutionalization of deposit and employment insurance systems		—	—	—	
			Prepare a program for rebuilding of the financial sector	*				
			Removal of the ISSBE surcharge and its coverage by alternate fiscal measures	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing				
				1986	87	88	89	90
C. FISCAL SYSTEM								
1. Tax Structure	Broaden the corporate tax base	Inclusion of rural properties to capital gains tax	Include profits on the sale of property		*			
	Improve the buoyancy of tax system, shift the burden to direct taxation		Elimination of most industrial incentive exemptions from VAT.		—	—		
			Focusing excise taxes on commodities where Government has direct control over the collection	*				
	Eliminate anti-export bias of the tax system		Introducing a federal land tax as export taxes are phased out		*			
2. Tax Administration	Improve the effectiveness of tax administration		Unification of tax payer identification for each separate tax collecting entity	—	—	—		
			Phasing out expensive visit system in favor of distribution of information on cross--compliance	—	—	—	—	
			Increased penalties for evasion and tax delinquency	—	—			
			Concentrating audit efforts on VAT	—	—	—	—	—
			Elimination of tax amnesties	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
D. PUBLIC SECTOR								
1. Central Govt., Public Enterprises and Investment	Definition of medium-term public/private sector roles		Decison to restructure and privatize public enterprises.	*				
	Improve efficiency of operations	A commission for the privatization of a group of public enterprises has been established.	Establish clear criteria for public enterprise management on a commercial basis.	*				
	Eliminate bottlenecks constraining trade expansion	A set of studies to guide public sector reform has been initiated.	Reduction of public employment through attrition.			—	—	—
			Wage differentiation and productivity bonuses.		—	—	—	
			Introduction of managerial accountability and cost accounting.	—	—	—		
	Phase-out public sector investment in non priority areas		Phasing out the production of goods and service lines.		—	—	—	
			Phasing divestiture of those enterprises that are not producing a true public good and/or service.		—	—	—	—
			Elimination of budgetary support to enterprises and preferential credit.	—	—	—	—	—

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
	Mobilize and allocate resources to priority investments	National Development Council (CONADE) was reestablished to redirect public investment	Elimination of earmarked funds for non-priority projects.		*			
			Allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources;		—	—	—	
			continuation of real increases in water and electricity tariff revenues;	—	—	—	—	—
			and preparation of a medium-term public sector investment program and financing plan and external borrowing program.	*				
2. Energy Sector	Better use of energy resources	Major cuts and postponements in several energy projects	Government decision on the expansion of the gas transportation system through private participation Solution of the COGASCO dispute.	*				
	Enhance the private sector's role and improvement of oil export possibilities	A five-year investment program for the sector is being prepared	Award new exploitation and exploration contracts for oil and gas to private firms.	*				

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Provision of safeguards against the risks of convertibility for foreign investors.	*				
	Improve the operations of state oil and gas companies		Reduction of investment and operating costs, financial strengthening and streamlining of organizational structures, accounting and control systems,	—	—	—		
			preparation of the restructuring options for YPF.	—	—			
	Mobilize potential financial resources		Adjustment of the price of natural gas taking its long run opportunity cost as a guide.	—	—			
	Promote energy conservation		Adjustment of the price of diesel as a function of the gasoline price,		*			
			preparation of the deregulation of oil and petroleum products.				—	—
			Design and implementation of an energy conservation program including price and taxation aspects.			—	—	
			Reviews of the energy efficiency of the power sector and of the possibilities for conversion and savings.		—	—	—	—
			Minimization of coal investments and postponement of major hydroelectricity projects.		*			

Area	Policy Objectives	Recent Actions Taken by Government	Further Measures Recommended	Proposed Timing				
				1986	87	88	89	90
3. Transport Sector	Reduce deficits Provide adequate facilities for export trade		Assurance of adequate cost recovery in ports, channel dredging, and railroads and the introduction of road user charges.		—	—		
			Strengthening of transport planning and intermodal coordination.		—	—		
			Consolidation of agencies working in the same sector.		—	—	—	
			Railways: Overhauling company, cutting uneconomic lines, providing bulk freight, improving maintenance, elimination of electrification schemes.		—	—	—	—
			Highways: Better maintenance of main traffic corridors, concentration on feeder roads with higher traffic.		—	—	—	—
			Ports and Maritime Transport: Deregulation of offshore storage/shipping, containerization, tugboat services.		*			
4. Restructuring	Restructuring to improve efficiency and competitiveness of basic industries		SOMISA: cut costs, balance production lines and strengthen management/administrative practices.				—	—
			ENTEL: improve operation and managerial efficiency.				—	—
5. Privatization	Programs for privatization of public enterprises		Petrochemicals: (i) identify potential investors;		—			
			(ii) negotiate the sale price value of assets;				—	—
			(iii) define the vehicle of transfer of assets to private investors.				—	—

SECTOR POLICIES

1. This section identifies the major sectoral features that are necessary for policy reform to resume and sustain medium-term growth in Argentina. The purpose of the policy framework is to identify factors that have constrained growth, define policy objectives to eliminate such constraints, recommend specific policy changes, and indicate the possible effects of the proposed policy changes.

2. There are two major constraints for the resumption of sustained growth in Argentina: (a) the underlying distortions in the economy and (b) the inefficiencies in the operation of the public sector. Elimination of these constraints requires improving the incentives system necessary for a more intensive use of resources to increase production and exports, and undertaking a series of actions to improve the efficiency of the public sector. Carrying out these tasks will require the removal of distortions in the trade regime, the phase-out of the price freeze, restoration of domestic financial markets, the strengthening of the tax system and an overall improvement of the machinery of government, notably, sound public investment screening mechanisms, requiring public enterprises to operate like commercial entities, and defining an adequate framework for an expanded private sector role. Thus, this section is divided into two parts. Part I deals with the incentives system necessary for the resumption of growth and focusses on the elimination of distortions, reformation of domestic financial markets, and increasing the effectiveness of the tax system. Part II deals with improving the efficiency of the public sector, and focusses on the public sector investment program, with special emphasis on the energy and transport sectors which comprise over half of the public sector investment program. It also examines the possibilities of restructuring and privatization of public sector industrial enterprises as a means to help reduce the Government's financial burden and public sector deficits, and to increase industrial efficiency, competitiveness and exports.

I. IMPROVING THE INCENTIVES SYSTEM

AGRICULTURE

A. Analysis

3. The agricultural sector has been growing below potential as a result of pricing policies that have: (a) depressed domestic prices for outputs through export taxes; and (b) artificially raised the costs of some key farm inputs through import tariffs and quantitative restrictions. As a consequence, most farmers have opted for low-risk; lower-input technologies which led to a significant underutilization of production and export potential. Also, the inadequacy of transport, storage, information and marketing facilities has raised the final costs of agricultural products and discouraged the production of new commodities.

4. The total agricultural sector credit portfolio in each of the last few years has been less than 50% of the portfolio registered in 1980. The economic uncertainty has negatively affected the demand for investment credit. In the case of short-term production credit, inadequate supply by the Banco de la Nacion and provincial banks has been a constraining factor. The Government's stabilization program has restricted credit further. Yet, maintenance of the growth of the agricultural sector will require substantial increases in both production and investment credit.

5. Policy objectives in agriculture should focus on: (a) reducing export taxes on agricultural products, providing alternative sources of fiscal revenue to compensate for the export tax reduction so as to maintain the overall fiscal deficit at satisfactory levels; (b) rationalizing import laws and regulations on agricultural inputs, (c) strengthening marketing efforts; and (d) providing sufficient credit resources to the sector.

B. Policy Recommendations

6. Specific changes recommended include:

(a) phased reduction of export taxes on agricultural commodities. The timetable of such an export tax reduction should include by: (i) January 1986, the removal of temporary increases imposed in June 1985; (ii) end-1986, the reduction of export taxes to no more than 70% of the rates in force on May 1, 1985; and (iii) January 1988, the reduction of export taxes to no more than 50% of the rates in force on May 1, 1985; and (iv) January 1990, the reduction of export taxes to 5% of the FOB value of agricultural exports;

Why not 0%? contradicts para 22 pg 22

(b) introduction of a federal land tax and of alternative tax provisions to compensate for the revenue losses resulting from the export tax reduction program;

(c) removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985;

(d) redesignation of tractors and agricultural machinery from the "prohibited" to the free imported.

(e) marketing policies should be geared to: (i) promote the participation of the private sector, especially cooperative organizations, marketing; and (ii) provide marketing infrastructure to promote the development of new agriculture commodities; and

(f) make adequate resources available to financial institutions to meet the demands for both long-term and short-term credit in the sector;

C. Potential Results

7. The policy reforms would stimulate increases in agricultural production and exports by: (i) increasing domestic producer prices, bringing them closer to international prices and improving benefit-cost ratios for investment and production inputs; (ii) reducing the subsidy from producers to consumers; and (iii) improved marketing and increased credit. The introduction of a production-neutral federal land tax substituting for production-negative export taxes would represent a structural change in Argentina's taxation system.

MANUFACTURING

A. Analysis

8. Argentina's manufactured exports have been influenced substantially by the overall trade regime, which has, in the last five decades, been largely protectionist, creating a strong inward-looking bias in the economy. Industrial export promotion has been generally seen as secondary to import-substituting industrialization. As a number of incentives and disincentives for different products were introduced, a multiplicity of effective exchange rates emerged, with exports of traditional goods receiving the lowest rates. The system ultimately succeeded neither in eliminating the anti-export bias in the highly protected industries nor in sustaining the traditional manufacture and agriculture. The incentives regime was rendered particularly inadequate during the 1977-81 import liberalization attempt. Argentina's manufacturing sector is still badly shattered by that unfortunate import liberalization experience, adopted concurrently with a revaluation of the domestic currency.

9. The present tariff regime has been in place since January 1984. As of October 1984 (the last date for which detailed information is available), the range of tariff duties was 0-38%, with an average rate of 22.8%. The average tariffs for the major sectors of the economy were, in fact, quite close to that mean, and they point to little dispersion of average tariffs across major economic sectors: in the agriculture and mining sectors, they are, respectively, 19.9% and 25.2%, while in the manufacturing sector, 22.9%.

10. Manufacturing has the potential for export-oriented output growth, with attendant foreign exchange earnings and employment creation. The sector lacks a clear development strategy, institutional support and consistent policy signals. The main issue is how to redress the strong anti-export bias built onto the complex systems of tariff and non-tariff protection while maintaining an exchange rate adequate enough to restore export competitiveness. Policy objectives in manufacturing should focus on the implementation of an outward looking development strategy by introducing reforms to reorient the economy towards export promotion. This should include: (a) phased elimination of import prohibitions and quantitative restriction, and of export restrictions; (b) reorientation of export policies so as to reduce the discretionary element and provide automaticity and uniformity of access to incentives and foreign exchange in order to provide free-trade status for export industries; (c) improvement of the administrative mechanisms of trade management; and (d) preparation of

studies on tariff protection and rationalization of the system of tax rebates to exports as a basis for further policy reforms.

B. Policy Recommendations

11. Specific changes recommended include:

(a) the gradual elimination of most import licensing requirements as follows: (i) reclassification of about 4,000 (100%) tariff positions from prohibited to free and partial replacement by tariffs; and (ii) gradual reclassification of about 1,300 (100%) tariff positions from prior consultation to free and partial replacement by tariffs.

(b) achievement of neutral status for export industries, through the reform of the temporary admission regime for imported inputs as follows: (i) simplification of administrative procedures; (ii) guarantee of automatic access for any input; (iii) coverage of indirect exporters; (iv) extension to capital goods used for export production; and (v) extension of the tax reimbursement scheme to exports processed under the temporary admission regime;

(c) simplification of export procedures, eliminating all unnecessary interventions by public sector agencies;

(d) preparation of the following studies needed to support the adjustment process: (i) tariff protection, with a view to reducing tariff dispersion; and (ii) the indirect tax content of exports, with a view to rationalizing the system of tax rebates to exports, as well as to strengthen it vis-a-vis trading partners that might be tempted to impose countervailing duties;

(e) extension of export financing: (i) removal of the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits; (ii) facilitating joint financing by banks; and (iii) reviewing the level of financing subsidies; and

(f) establishment of an export assistance and information system: (i) allowance of export plans by firms as a basis to determine the amount of Central Bank credit lines for financing; (ii) broadening risk coverage of exporting firms; (iii) formation of a joint organization to provide institutional support for marketing, storage, quality guarantee, legal assistance, lobby; and (iv) development of a common, integrated data base.

C. Potential Results

12. The following projections for 1986-90 reflect the potential impact of the proposed policy changes, predicated on the basis of a timely implementation and supported by massive export promotion efforts and by improved management and recapitalization of enterprises in the private sector: (a) exports of manufacturing goods are projected to grow on average by about 4.9% in real terms during 1986-90, from 0% in 1985; (b) imports of goods

are projected to grow on average by about 4.7% in real terms on average during 1986-90, from a drop of 3% in 1985; and (c) the current account deficit of the balance of payments is projected to fall from an estimated US$2.2 billion in 1984 to an estimated US$2.1 billion in 1986 and turn into surplus of US$1.2 billion in 1990.

FINANCIAL SYSTEM

A. Analysis

13. The efficiency of the financial system will be a key element in the speed and effectiveness of the recovery in Argentina. Once the economy has reached capacity in the productive sectors, the availability of credit at realistic interest rates will be the key to stimulating investment in future productive capacity. The financial sector, having been severely battered over the past decade, is in a poor position to provide the type of efficient service that the economy is going to need. It is currently characterized by substantial overexpansion and by intermediation spreads of as much as 4% real per month reflecting not only an overall scarcity of funds, but more importantly, substantial inefficiencies in the system itself. Even with more normal levels of money supply in the economy, it is estimated that financial institutions would need spreads of 1.5% to 2% per month to break even. In effect, the system has operated like an oligopoly, despite the large number of participant institutions, protecting the least efficient ones and guaranteeing large economic rents to the more efficient ones. Analysis of the sector also indicates that low productivity is not confined solely to small institutions and that a policy of encouraging mergers will not, in itself, solve the problem. Other factors working to increase interest rate spreads include the 2% surcharge used to finance the Institute of Social Services for Bank Employees (ISSBE).

14. The goal of the reform of the financial sector should be to eliminate distortions and allow the market to define the spreads between the deposit rate and the lending rate. The increased monetization of the economy will then be reflected in declining interest rates.

B. Policy Recommendations

15. While a return to more normal levels of money supply in relation to GDP will certainly help to create a more healthy financial sector, there are a number of specific policy measures that must be taken within the sector itself:

(a) restructuring of the sector by means of (i) increasing the minimum capitalization required for financial institutions; (ii) temporary fiscal measures to encourage consolidation; and (iii) a program aimed at public as well as private banks and at large as well as small;

(b) removal of the ISSBE surcharge and its coverage by alternate fiscal measures;

(c) shifting the bulk of reserve requirements on sight deposits with a very low requirement, say 10%, on time deposits; and are projected to grow on average by about 4.7% in real terms on average during 1986-90, from a drop of 3% in 1985; and (c) the current account deficit of the balance of payments is projected to fall from an estimated US$2.2 billion in 1984 to an estimated US$2.1 billion in 1986 and turn into surplus of US$1.2 billion in 1990.

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(b) removal of the ISSBE surcharge and its coverage by alternate fiscal measures;

(c) shifting the bulk of reserve requirements on sight deposits with a very low requirement, say 10%, on time deposits; and

(d) elimination of credit subsidies.

C. Potential Results

16. The above reforms should be sufficient for the market to function, lowering real intermediation spreads and allowing the development of an interest rate structure that would attract deposits while not discouraging investment in new plant and equipment. The restructuring of the banking system is bound to be gradual, however, and the economic and political costs of required adjustments may be high.

TAX ISSUES

A. Analysis

17. Argentina's basic tax structure is sound and appropriate for its level of development, including taxes on income, wealth, and value added. The revenue generated by the tax system, however, has been characterized in recent years by high volatility. Poor tax administration and widespread leakages through exemptions have led to a serious deterioration of government tax revenues. Total taxes collected are less than 20% of GDP. Income taxes amount to only 1.5% of GDP, and the value added tax (VAT) yields, in spite of the 18% rate, only 3.5% of GDP. Customs and excises are too high a share of revenues for a country of Argentina's level of development and create significant distortions both on the supply and on the demand side of the economy.

18. Policy objectives in the tax area should focus on increasing the yield from the existing structure through better administration of income, value added, and wealth taxes. There is strong evidence that tax administration has been hampered by poor information, frequent tax changes, repeated amnesties, and by penalty interest rates substantially below the taxpayer's cost of capital. Argentina's goal should be to raise tax revenue within the existing tax structure with emphasis on the elimination of tax exemptions and loopholes.

B. Policy Recommendations

19. Specific changes recommended include:

(a) taxes on foreign trade: to be significantly phased out for agricultural exports;

(b) property taxes: introduce a production-neutral federal land tax, including an accurate cadastre;

(c) tax administration: (i) unification of taxpayer identification for each separate tax collecting entity; (ii) phasing out of expensive "visit" system in favor of distribution of information on "cross compliance"; (iii) concentration of audit efforts on VAT; (iv) sharply increased penalties for evasion; (v) penalty interest for delinquency to be set significantly above taxpayers' cost of capital; and (v) elimination of amnesties;

(d) income taxes (corporate): to be left largely as is except to: (i) broaden tax base; and (ii) include profits on the sale of agricultural properties;

(e) wealth taxes: (i) to be extended (due to run-out in 1985) as is; and (ii) to eliminate deduction of 50% of assessed value of agricultural property;

(f) taxation on goods and services: (i) turnover tax to remain unchanged; and (ii) in VAT eliminate most of exemptions given for industrial incentives purposes; and

(g) excise tax: (i) not to be broadened; and (ii) focus on commodities where government has direct control over the collection (e.g., gasoline).

C. Potential Results

20. The overall target would be for tax revenues to gradually reach 25% of GDP by 1990, a level which would be adequate to allow for real increases in public services and an increasing contribution of government savings to investment.

II. IMPROVING THE EFFICIENCY OF THE PUBLIC SECTOR

21. A framework for reforming the public sector should include the medium-term role of the public sector in the productive areas; through restructuring and divesting public enterprises. Public sector's share in total investment should also gradually decrease. Public enterprises should not have preferential access to credit. Budgetary policy should be such that only transfers for equity take place and that operating losses of enterprises not be financed by either the Central Bank or the budget. Finally, enterprises should be managed as commercial entities, including policies over wages, product prices, recruitment and dismissals.

PUBLIC SECTOR INVESTMENT AND FINANCING

A. Analysis

22. Since 1977, public investment has declined by 60% in real terms. In recent years, the Government has encountered difficulties cutting current expenditure and has resorted to sharp cuts in investment. The cuts have been made haphazardly, and essential services have deteriorated. The critical areas where deterioration has reached a scale to constrain the expansion of trade are the following.

(a) Port services are not adequate for an expanded volume of grain exports. The bottlenecks are likely to become even more serious if exports continue to expand.

(b) Exploration and exploitation of hydrocarbon resources have fallen behind the country's estimated potential. As soon as the economy recovers, consumption will increase and the country may face the danger of becoming an importer of hydrocarbons.

(c) Roads feeding main transport corridors are either lacking or have deteriorated seriously. The agricultural export potential (especially fruits/vegetables) is not being fully exploited because of high transport costs/quality deterioration resulting from incomplete/bad feeder roads.

(d) The telecommunications network is inadequate to meet the needs of business and residential users. Waiting lines for telephone installation stretch to 5-7 years, raising operating costs significantly.

B. Policy Recommendations

23. Policy reforms are extremely difficult to achieve in this sector. Some of the proposals outlined below have been previously recommended, as far back as 25 years ago. Specific changes proposed include:

(a) rapid completion of dredging and the reconstruction of hinterland services at the Bahia Blanca port; and encouragement of private sector to build river ports;

(b) concentration of YPF's (the State Oil Company) resources on oil exploitation and liquid extraction, gas gathering and enhanced oil recovery projects; and accelerating the projects of oil and gas pipeline construction, particularly those for Formosa oil fields and for Lujan de Cuyo;

(c) increased emphasis on road reconstruction and maintenance and gravel surfacing on roads with more than a minimum (e.g., 100) average daily traffic; shifting railway transport operations to bulk freight with unit trains over a basic network of 16,000 km; emphasis on railway track renewal and bridge/culvert repairs; and

(d) encouragement of private sector participation in the provision of telephone services.

24. The public investment budget will continue to be tight in the foreseeable future. At the same time, average public tariffs for users have already reached--with the exception of water supply and electricity--a level above which Argentine producers' international competitiveness could be negatively affected. Therefore, priority investments should increasingly have to be financed from increasing productivity, revenue sharing and cuts on non-priority investments. These are highly desirable but difficult to achieve.

(i) productivity increases: (i) reduction of public employees through attrition; (ii) provision of adequate wage differentiation and production incentives; (iii) reinforcement of managerial accountability and introduction of cost accounting in public enterprises; (iv) cutting uneconomic production lines and transport losses; and (v) restructuring of some enterprises to expose them to competition;

(ii) revenue sharing: (i) elimination of earmarked funds for non-priority projects; (ii) allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources; and (iii) real increases in water and electricity tariff revenues;

(iii) actions on non-priority investments: (i) in the energy sector minimization of coal investments and postponement of major hydroelectricity projects; (ii) in road transport, reduction of investments in upgrading/capacity, and decreases in "strategic" roads with very low traffic and in new paving; (iii) in railway transport, elimination of new electrification schemes, and reduction of investments in passenger traffic; (iv) in maritime transport slowing down the expansion of the merchant fleet; and (v) in industry, cancellation of the expansion of the petrochemical production capacity in Bahia Blanca, of the new sheet steel rolling mill by SOMISA, and of the expansion of shipyards.

ENERGY

A. Analysis

25. Falling proven oil reserves and heavy reliance on petroleum as the primary energy source jeopardize Argentina's self-sufficiency in liquid fuels. Substantial new drilling is needed to maintain production in order to avoid imports. Proven and potential reserves of gas are almost twice as important as those of oil, but increased use of gas (including its possible export) is constrained by the limited transport infrastructure. Rationalization of oil and gas development requires more attractive and stable incentives for the private sector, clarification of the latter's role vis-a-vis the Government's, bringing absolute as well as relative prices of hydrocarbon products more in line with the economic cost of fuels, and strengthening public sector agencies in the energy sector, notably their financial condition and planning framework.

26. The Government's past efforts in the oil and gas sector focussed on exploration and production of oil to assure self-sufficiency and substitution of relatively abundant gas for liquid fuels. Energy conservation received little attention. The petroleum sector has the potential not only to assure the country self-sufficiency in oil but also to produce significant surpluses for export. At the same time, it has the potential to contribute significantly to reducing the overall fiscal deficit. It would be possible to continue to substitute gas for liquid fuels if a significant expansion of gas transmission infrastructure can be achieved during the next three to four years. Over the medium and longer term, Argentina's oil and gas reserve base could be expanded and important energy conservation efforts should be supported.

27. Policy objectives on oil and gas should focus on the following areas: (a) developing the infrastructure for oil and gas transport; (b) defining an adequate framework for an expanded private sector role; (c) rationalizing price structures and taxation; (d) financial and institutional restructuring of major public enterprises in the energy sector; and (e) launching of an energy conservation program.

B. Policy Recommendations

28. Specific changes recommended include:

(a) infrastructure: (i) government decision on the expansion of the gas transportation system (and corresponding gas gathering, treatment, and distribution through significant private sector (local and foreign) participation. Specifically, whether to expand the Central-West pipeline or to construct a new pipeline from Neuquen via Bahia Blanca to Buenos Aires; and (ii) solution of the COGASCO dispute would also be an integral part of this decision;

(b) private sector role: (i) encourage private sector participation by awarding new exploitation and exploration contracts to private firms which have the financial and managerial capabilities to supplement YPF's efforts in order to expand oil and gas reserves; and (ii) limit or eliminate convertibility risks (i.e., exports of products as guarantee for foreign currency obligations) and facilitate access to domestic credit (i.e., "apex" financing arrangements to support private sector borrowing needs);

(c) public enterprises: strengthen financially YPF and gas del Estado and reorganize their accounting and control systems;

(d) pricing and taxation: (i) adjust the price of natural gas, taking its long-run opportunity cost as a guide; (ii) adjust the price of diesel as a function of the regular gasoline energy equivalent; (iii) review the level and structure of prices of other energy products; (iv) review relationship with energy conservation incentives; and (v) review the costs and benefits of the existing structure of taxation of the energy sector with a view to increasing efficiency; and

(e) conservation: (i) design and implement an energy conservation program including pricing and taxation aspects; and (ii) study of the energy efficiency of the power sector and of the possibilities for end-user conversion and savings.

C. Potential Results

29. Official reserve estimates assume that only 19% of the oil in the ground may be recovered. This appears low by international standards. It may well be that a recovery rate of around 25% or more is possible. This would increase proven reserves fron around 370 million cubic meters to over 600 million cubic meters of oil and would allow exports of crude oil or petroleum products of around 70,000 - 100,000 barrels per day amounting to US$0.6 - 1.0 billion (at US$24 per barrel). New resource discoveries combined with energy conservation efforts should allow Argentina to maintain self-sufficiency in energy use for the next two or three decades.

30. Over the next five years, annual investments of US$1 billion or more would be required in the petroleum sector and around US$500 million in gas transmission and distribution. Under the foreseeable constraints on government investment funds, neither YPF nor GdE will be able to finance

such programs on their own, nor would they have the capacity to implement them. However, by involving the private sector and by using new financing instruments such as limited recourse financing and funds from international development banks, implementation of such investment programs would be feasible even in the present environment of tight public investment funds. The efficiency of these undertakings could be significantly improved by restructuring YPF and by deregulating the present pricing policy framework in the petroleum sector. YPF's investment program which was already reduced from a high of US$1.8 billion in 1980 to about US$900-1000 million (including dry wells) in 1985 could be further reduced to around US$600 million by the late 1980s. Offering areas for exploration to private sector firms could reduce investment needs for YPF by US$100-200 million per annum. New exploration contracts could decrease YPF's investment requirements for production and provide the capacity to achieve the export targets mentioned above before the end of the decade. US$200-300 million of investments per year appear to be an achievable target for private sector production activities.

TRANSPORT SECTOR

A. Analysis

31. Public enterprises in the transport sector are an important drain on the Treasury's financial resources on account of their operating deficits and their investment programs. At the same time, their efficiency has an important bearing on the profitability of export-oriented domestic production and on reducing the cost of bringing imports into the country.

32. The sector is beset by bottlenecks and idle capacity which go side-by-side as a result of poor resource allocation and disinvestment, serious deterioration of infrastructure, poor maintenance, and obsolescence of rolling stock and fleet. There is little intermodal coordination; responsibilities of transport agencies are unclear, and the roles of the public and private sectors remain largely undetermined. Funds are earmarked for specific modes of transport or institutions without taking into account demand and rate of return criteria. Planning systems, staffing and information are inadequate. The Ministry of Public Works and Services lacks systematic information on project preparation and monitoring. There has been a major loss of experienced and trained staff while underemployment of lower level personnel has increased.

33. Policy objectives in transportation should focus on: (i) measures necessary to allow public enterprises to operate like commercial entities, including increased prices for public services, and adequate cost recovery; and (ii) policies to improve sector planning, investment follow-up, reduce public sector investment requirements through increased private sector participation, and deregulate and privatize transport sector activities.

B. Policy Recommendations

34. Policy reforms are extremely difficult to achieve in this sector. Some of the proposals outlined below have been previously recommended as far back as 25 years ago.

(a) increased prices of public sector services to ensure adequate cost recovery in, ports dredging, and railroads, and the introduction of road user charges;

(b) improvement of efficiency of operation of the railways. Since this is an area where all previous efforts have failed, it would represent a major task. It should include: (i) reduction of manpower (currently 108,000), closure of uneconomic lines, generation of operation/line-specific economic information to allow the assessment of the merits of expenditure programs; (ii) an overall reduction of the 1986-90 investment expenditures by 60%; and shifts in investment priorities: from passenger traffic to bulk freight (using unit trains over a basic network of 16,000 km); from the expansion of rolling stock (limiting purchases to replacement needs) and new electrification schemes to track renewal and bridge and culvert repairs; and to investments to control of operations, including the coordination of broad-gauge lines;

(c) improvement of efficiency of operation of maritime and air transport. This should include: (i) reduction in total investment expenditure; introduction of a toll system to cover major reequipment costs; efficiency improvements of import dredging operations; and elimination of legal obligations to buy from domestic shipyards; and (ii) shifts in investment priorities from the expansion of the merchant fleet to dredging and port support services and elevators, and from a possible air fleet standardization investment to the improvement of air traffic control systems;

(d) strengthening of MOSP planning and follow-up including the restoration of national transport planning as part of the global public investment planning mechanism, and the elimination of earmarked funds. In most road transport, priorities need to be shifted (i) from upgrading/capacity increases to reconstruction (current investment projects allocate 73% and 26%, respectively, to the former and the latter); (ii) from projects that are not likely to yield acceptable rates of return (due to expected traffic levels below minimum), that are allocated 52% of total investment expenditure, to higher traffic corridors; and (iii) from new paving projects with expected average daily traffic (ADT) of less than 100 to gravel surface projects with higher ADT;

(e) initiation of institutional reforms such as consolidation of port agencies and urban rail authority, and agreement on studies to implement action programs in the sector; and

(f) deregulation and privatization in areas of offshore storage/shipping facilities, containerization, tugboat service, and highway maintenance.

C. Potential Results

35. Action on the above areas would result in a more efficient and less costly transport operation in support of Argentina's export promotion efforts. At the same time, the negative effects on the overall public sector deficit will be significantly reduced.

RESTRUCTURING AND PRIVATIZATION

A. Analysis

36. Restructuring and privatization of public sector industrial enterprises provide a further means to help reduce the Government's financial burden and public sector deficits and to increase industrial efficiency, competitiveness and exports. These are important areas of policy consideration because future growth possibilities of the economy may hinge critically on the ability of the Government to keep down public sector deficits, which otherwise could lead to uncontrollable upward pressures on inflation, interest rates and/or taxes.

37. Policy objectives in restructuring and privatization should focus on: (a) restructuring of public sector enterprises which often have large potential for cost reductions or which, through their linkages, could have a significant impact on the efficiency and competitiveness of other parts of the industrial sector as well as the rest of the economy; and (b) privatization of select state-owned enterprises.

B. Policy Recommendations

38. Specific actions recommended include:

(a) technical, financial and organization/management restructuring of selected public enterprises or subsectors to improve the efficiency and competitiveness of basic industries. The most significant benefits from restructuring can be expected in steel (mainly SOMISA) and telecommunications (ENTEL). Systematic restructuring/rationalization should focus on improvements in: (i) organizational structures and management and administrative processes, including the degree of the enterprises' autonomy and the nature of their relationship with the Central Government; (ii) balancing and/or modernization of existing production lines; (iii) production management techniques (e.g., inventory and other working capital management, appropriate balance between production capacity and size and composition of work force; (iv) financing; and (v) pricing/cost recovery techniques;

(b) mounting a comprehensive program for privatizing public enterprises especially in the productive sectors (e.g., petrochemicals) which should include: (i) the identification of potential local and foreign private sector investors who would be interested in the purchase of state-owned assets; and (ii) the determination of vehicle of transfer of assets to private investors, e.g., stock market, international competitive bidding, etc.

C. Potential Results

39. Benefits of restructuring/privatization programs are likely to be significant for other productive subsectors through cost reductions and efficiency components, as well as through linkage and potential impacts on competitiveness. In the near term, the efforts toward privatization could

help reduce the public sector deficit and support the Government's stabilization objectives. In the longer term, through better exploitation of the benefits of private initiative and entrepreneurship, they could also lead to significant efficiency improvements in many segments of the economy, help stimulate direct foreign investment, and facilitate export development.

Table 1: ARGENTINA - Summary of Key Macroeconomic Aggregates, 1978-1985

(percentages)

	1978	1979	1980	1981	1982	1983	1984	Estimated 1985
GDP Growth Rate	-3.4	6.7	0.7	-6.2	-5.2	3.1	2.0	-3.3
Debt/Export Ratio 1/	1.62	2.0	2.5	3.1	4.6	4.8	4.7	5.1
Interest/Export Ratio 2/	1.69	14.6	20.4	33.0	51.6	56.8	55.8	47.5
Total Debt/GDP 3/	23	28	31	40	63	61	62	66
Interest Payments/GDP 4/	2.4	2.1	2.5	4.3	7.0	7.2	7.0	7.0
Debt Service Ratio 5/	38	24	31	43	65	71	64	66
Terms of Trade	78	83	94	107	92	88	93	89
Import Growth Rate 6/	-4.9	45.4	45.4	0.4	-41.2	-2.4	1.5	-0.3
Export Growth Rate	12.2	-3.0	-4.9	5.9	-2.4	11.5	-1.2	4.6
Current Account Balance	1,833	-537	-4,767	-4,714	-2,357	-2,461	-2,492	-2,200

Interest on Ext. Debt

1/ Total debt including short-term/exports goods and NFS; absolute ratio.
2/ Total interest payments to exports goods and NFS.
3/ Total debt including short-term/GDP.
4/ Total interest payments/GDP.
5/ Total interest and amortization on MLT divided by exports of goods and non factor services.
6/ Real growth rates in 1970 prices.

Table 2.A: ARGENTINA - Projections of Key Variables, 1985-1994, Base Case Scenario
(percentages and 1984 U. S. Dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP growth rate	-3.3	3.4	2.9	3.1	3.1	3.0	3.1	3.1	3.2	3.2
GDP/capita	1,986	2,001	2,016	2,031	2,046	2,061	2,077	2,092	2,108	2,124
Debt/Exports	5.1	4.8	4.5	4.1	3.7	3.4	3.4	2.9	2.6	2.4
Total Debt Outstanding and Disbursed (billions)	48.6	50.1	52.1	53.4	54.5	54.9	55.8	55.3	53.9	53.2
Debt/GDP)	66	62	58	54	50	45	43	39	35	32
Interest Payments/GDP	7	6	6	5	5	4	4	4	3	3
Debt Service ratio (exclud. short term)	66	65	50	44	43	42	39	40	41	34
Public Investment a/	2,477	2,576	2,679	2,786	2,897	3,013	3,134	3,259	3,389	3,525
Public Investment/GDP	5.0	5.0	5.1	5.1	5.2	5.2	5.3	5.4	5.4	5.4
Private Investment a/	3,827	4,114	4,443	4,799	5,183	5,597	6,017	6,468	6,954	7,475
Private Investment/GDP	7.7	8.0	8.4	8.8	9.2	9.7	10.1	10.5	11.0	11.4
Public Savings/GDP	6.9	6.4	6.2	5.7	5.7	5.5	5.2	5.0	4.9	4.7
Private Savings/GDP	10.9	12.1	12.6	13.5	14.0	14.5	15.2	15.8	16.3	17.0
Exports Growth Rate	4.6	6.5	2.5	3.0	3.4	2.4	3.0	2.9	3.5	3.6
Exports/GDP	14.2	14.6	14.5	14.5	14.5	14.4	14.4	14.4	14.5	14.5
Imports Growth Rate	-1.0	4.3	3.6	3.6	3.6	3.6	4.0	4.0	4.1	4.1
Imports/GDP	9.1	9.1	9.2	9.2	9.3	9.3	9.4	9.5	9.6	9.7
Consumption/Capita Growth Rate	-4.0	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
GNP Growth Rate	-3.2	4.2	3.5	3.8	3.3	3.5	3.6	3.3	3.5	3.6
GNP/Capita	5,513	1,549	1,575	1,606	1,630	1,657	1,686	1,711	1,740	1,771

a/ In thousand billions of 1984 pesos.

Notes:

1. Debt includes public and publicly guaranteed, private non-guaranteed and short term debt.
2. Exports and imports include that of goods and non-factor services.

Table 2.B: ARGENTINA - Projections of Key Variables, 1985-1994, High Case Scenario

(percentages and 1984 US dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP growth rate	-3.3	3.6	3.4	4.3	4.6	4.5	4.4	4.3	4.4	4.4
GDP/capita	1,986	1,996	2,011	2,036	2,066	2,108	2,150	2,193	2,237	2,281
Debt/Export	5.1	4.8	4.4	3.9	3.4	2.9	2.8	2.6	2.4	2.2
Total Debt Outstanding and Disbursed	48.6	50.1	51.9	52.5	52.6	53.2	53.9	54.3	54.8	55.2
Debt/GDP	67	62	58	52	46	42	39	36	36	33
Interest Payments/GDP	7	6	6	5	5	4	3	3	3	2
Debt Service Ratio (exclud. short term)	66	64	49	42	47	39	31	30	28	26
Public Investment[a]/	2,477	2,650	2,836	3,020	3,201	3,377	3,546	3,723	3,909	4,105
Public Investment/GDP	5.0	5.2	5.3	5.4	5.5	5.6	5.6	5.6	5.7	5.7
Private Investment[a]/	3,827	4,210	4,631	5,187	5,757	6,333	6,903	7,455	8,051	8,696
Private Investment/GDP	7.7	8.2	8.7	9.4	9.9	9.9	10.5	10.9	11.3	12.1
Public Savings/GDP	6.9	7.6	7.3	6.9	6.8	6.5	6.1	5.8	5.6	5.3
Private Savings/GDP										
Private Savings/GDP	10.9	11.2	12.1	13.4	14.4	15.2	16.0	16.7	17.3	18.1
Exports Growth Rate	4.6	7.1	3.8	6.3	6.8	4.0	4.3	4.1	5.0	4.9
Exports/GDP	14.2	14.7	14.7	14.9	15.2	15.2	15.2	15.1	15.2	15.3
Imports Growth Rate	-1.0	4.7	4.2	4.8	4.9	4.8	5.0	4.8	4.9	5.0
Imports/GDP	9.1	9.1	9.2	9.2	9.3	9.3	9.3	9.4	9.4	9.5
Consumption/Capita Growth Rate	-4.0	0.5	0.8	1.3	1.5	2.0	2.0	2.0	2.0	2.0
GNP Growth Rate	-3.2	4.5	4.1	5.2	4.9	5.2	5.1	4.7	4.9	4.9
GNP/Capita	1513	1552	1587	1640	1690	1746	1802	1854	1911	1969

[a]/In thousand billions of 1984 pesos.

Notes:

1. Debt includes public and publicly guaranteed, private non-guaranteed and short term debt.
2. Exports and imports include that of goods and non-factor services.

.4 x .15 = .060 DS/GDP = 6%.

Table 3.A.1: ARGENTINA - Projections of Commitments, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	240	630	500	500	500	500	2,870
IDB (or other multilateral)	400	400	300	200	200	200	1,700
Bilateral Official Exp. Credit							
Suppliers' Credits	1,100	1,200	900	800	800	700	5,500
Commercial Banks	3,423 1/	1,989	1,871	920	344	0	8547
TOTAL	5,163	4,219	3,571	2,420	1,844	1,400	18,617

1/ Incl. rescheduling

Sep. rescheduling
new
+ money

Table 3.A.2: ARGENTINA - Projections of Disbursements, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	146	478	462	600	568	523	2,777
IBD (or other multilateral)	236	470	157	227	262	269	1,621
IMF	702	650	—	—	—	—	1,352
Bilateral Official Exp. Credit							
Suppliers' Credits	695	826	375	494	445	321	3,156
Commercial Banks	3,423	1,989	1,871	920	344	0	8,547
TOTAL	5,202	4,413	2,865	2,241	1,619	1,113	17,453

Table 3.A.3: ARGENTINA - Projections of Repayments, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	116	149	161	159	178	198	961
IDB (or other multilateral)	76	100	35	50	68	118	447
IMF	0	331	485	186	97	400	1,499
Bilateral							
Official Exp. Credit	143	249	168	222	388	413	1,583
Suppliers' Credits							
Commercial Banks	765	982	—	—	—	345	2,092
Direct Foreign Investment	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
TOTAL (including IMF)							

Table 3.A.4: ARGENTINA - Projections of Net External Flows, 1985-1990: Base Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	30	329	301	441	390	325	1,816
IDB (or other multilateral)	160	370	122	177	194	151	1,174
IMF	702	319	-485	-186	-97	-400	-147
Bilateral							
Official Exp. Credit	552	577	207	272	57	-92	1,573
Suppliers' Credits							
Commercial Banks	2,658	1,007	1,871	920	344	-345	6,455
Direct Foreign Investment (net)	214	246	285	330	384	447	1,906
TOTAL (incl. IMF and DFI)	4,316	2,848	2,301	1,954	1,272	86	12,777

Total as % of GDP?

Table 3.B.1: ARGENTINA - Projections of Commitments, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	240	630	800	900	900	900	4,370
IDB (or other multilateral)	400	400	300	200	200	200	1,700
Bilateral) Official Exp. Credit) Suppliers' Credits)	1,100	1,200	900	800	800	700	5,500
Commercial Banks	3,423	1,859	1,406	0	0	0	6,688
TOTAL	5,163	4,089	3,406	1,900	1,900	1,800	18,258

Table 3.B.2: ARGENTINA - Projections of Disbursements, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	146	478	672	970	968	923	4,157
IDB (or other multilateral)	236	470	157	227	262	269	1,621
IMF	702	650	-	-	-	-	1,352
Bilateral) Official Exp. Credit) Suppliers' Credits)	695	826	375	494	445	321	3,156
Commercial Banks	3,423	1,859	1,406	-	-	-	6,688
TOTAL (including IMF)	5,202	4,283	2,610	1,691	1,675	1,513	16,974

Table 3.B.3: ARGENTINA - Projections of Repayments, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	116	149	161	159	178	198	961
IDB (or other multilateral)	76	100	35	50	68	118	447
IMF	0	331	485	186	97	400	1,499
Bilateral) Official Exp. Credit) Suppliers' Credits)	143	249	168	222	388	413	1,583
Commercial Banks	765	982	0	80	1,337	755	3,919
TOTAL (including IMF)	1,100	1,811	849	697	2,068	1,884	8,409

Table 3.B.4: ARGENTINA - Projections of Net External Flows, 1985-90: High Case

(in millions of US dollars)

	1985	1986	1987	1988	1989	1990	TOTAL
World Bank	30	329	571	811	790	725	3,196
IDB (or other multilateral)	160	370	122	177	194	151	1,174
IMF	702	319	-485	-186	-97	-400	-147
Bilateral) Official Exp. Credit) Suppliers' Credits)	552	577	207	272	57	-92	1,573
Commercial Banks	2,658	877	1,406	-80	-1,337	-755	2,769
Direct Foreign Investment (net)	214	246	285	330	384	447	1,906
TOTAL (including IMF and DFI)	4,316	2,718	2,046	1,324	-9	76	10,471

Table 4.1: ARGENTINA - Projections of Debt Outstanding and Disbursed, 1985-90: Base Case

(in millions of US dollars, end of period)

	1985	1986	1987	1988	1989	1990	Change 1984/1990
World Bank	579	985	1,286	1,727	2,117	2,442	1,893
IDB (or other multilateral)	1,104	1,465	1,587	1,764	1,958	2,109	1,165
IMF	1,800	1,519	1,034	848	757	351	-747
Bilateral Official Exp. Credit	5,535	6,112	6,319	6,591	6,648	6,556	1,573
Suppliers' Credits Commercial Banks	36,291	37,298	38,928	39,848	40,192	39,847	6,214
Total Medium & Long Term DOD	45,309	47,379	49,154	50,778	51,558	51,305	10,098
Short Term Debt	5,005	4,500	4,000	3,500	3,578	3,995	-2,575
TOTAL	50,314	51,879	53,154	54,278	55,244	55,300	7,523

Table 4.2: ARGENTINA - Projections of Debt Outstanding and Disbursed by Source, 1985-90: High Case

(in millions of US dollars, end of period)

	1985	1986	1987	1988	1989	1990	Change 1984/1990
World Bank	579	908	1,419	2,230	3,020	3,745	3,196
IDB (or other multilateral)	1,004	1,465	1,587	1,764	1,958	2,109	1,165
IMF	1,800	1,519	1,034	848	751	351	-747
Bilateral							
Official Exp. Credit) Suppliers' Credits)	5,535	6,112	6,319	6,591	6,648	6,556	1,573
Commercial Banks	36,291	37,168	38,463	38,383	37,046	36,291	2,658
Total Medium & Long Term DOD	45,309	47,172	48,822	49,816	49,423	49,056	7,845
Short Term Debt	5,005	4,500	4,000	3,500	3,855	4,375	-2,195
TOTAL	50,314	51,672	52,422	53,316	53,278	53,427	5,650

(1) GDP growth not an obj; but a residual — [illegible]
not make much diff. → a presentational [illegible]

(2) Public-private savings mix → ↑ in dom. S
comes from private not public.

(3) Priorities of reform → is that right?

(4) World Bank share > comm banks why?

(5) No commer bank after 88 M can } ?
89 [illegible] }

(6) Sup [illegible] £0 by 1990 p8 2 Annex II contradicts para 22

Argentina

ARGENTINA

SELECTED ANALYTICAL VARIABLES FOR ECONOMISTS AND MANAGERS

ATLAS PER CAPITA GNP (CUR) (1983) =2,070
POPULATION IN MILLIONS (1983) =29.627
LT DEBT OUTSTANDING AND DISBURSED IN MILLIONS (CUR)(1983) =35,469.00
BALANCE ON CURRENT ACCOUNT IN MILLIONS (1983) =-2,439

	HISTORIC DATA		REFERENCE YEAR	RECENT DATA		EST. DATA		PROJ.DATA	
	1960-1973	1973-1980	1980	1981	1982	1983	1984	1985	1986
GROWTH OF GDP AGGREGATES (CONST)					GROWTH RATES				
1.GDP	4.30	1.84	54,409	-6.24	-5.20	3.07	2.04	0.00	2.91
2. AGRICULTURE	1.34	1.50	4,806	2.41	7.32	0.72	2.54	0.99	3.57
3. INDUSTRY	5.49	1.54	20,615	-13.09	-6.21	7.22	0.83	-0.52	3.99
4.GDP OUTPUT DEFLATOR	23.63	175.71	100	103.30	196.23	384.75	..	..	..
5.IMPORTS GNFS (NAT. ACCTS.)	2.88	9.05	13,947	-3.83	-42.09	-4.66	2.78	-1.52	3.63
6.EXPORTS GNFS (NAT. ACCTS.)	4.32	10.38	10,622	5.87	-0.98	8.38	-1.09	6.10	5.95
7.MERCHANDISE EXPORTS (1)	3.03	12.56	8,021	12.00	-1.79	-3.09	3.75	..	..
8.DOMESTIC ABSORPTION	4.09	1.94	57,734	-7.81	-11.08	1.41	-3.37	-1.20	2.71
9.INVESTMENT	4.80	3.66	14,530	-23.10	-15.33	-8.42	-18.19	-5.80	10.01
10.PER CAP TOTAL CONSUMPTION	2.31	-0.24	1,530	-4.22	-11.38	2.22	-1.68	-1.95	-0.14
11.POPULATION (MIL)	1.53	1.64	28	1.62	1.62	1.61	1.61	1.61	1.61
TRADE PRICE INDICATORS (1980=100)						INDICES			
12.TERMS OF TRADE OF AGR/IND	126.15	102.88	100.00	89.28	103.64	104.42	..	..	..
13.TERMS OF TRADE	107.87	99.85	100.00	116.34	90.92	98.61	..	..	..
14.TERMS OF TRADE (UNCTAD)	154.72	126.59	100.00	102.00	91.30	91.03	..	..	..
15.NOMINAL EFFECTIVE EXCHANGE RATE(2)	..	115.28	100.00	57.69	14.96	3.42	0.85	0.21	..
16.REAL EFFECTIVE EXCHANGE RATE(2)	..	88.04	100.00	92.28	51.30	43.36	51.13	50.05	..
INVESTMENT AND SAVINGS						RATIOS			
17.INVESTMENT/GDP (CURRENT)	20.0	25.2	25.7	18.6	17.9	13.4	..	..	..
18.INVESTMENT/GDP (CONSTANT)	23.0	24.2	25.7	21.1	18.8	16.7	13.4	12.6	13.5
19.DOMESTIC SAVINGS/GDP (CURRENT)	21.1	24.7	23.5	18.3	20.9	18.3	..	..	..
20.DOMESTIC SAVINGS/GDY (CONSTANT)	25.0	26.7	23.5	21.6	24.0	23.9	..	..	..
21.GROSS NAT. SAVINGS/GDP (CURRENT)	20.1	23.9	22.7	15.8	14.8	11.2	..	..	..
22.RESOURCE BALANCE/GDP (CONSTANT)	1.1	-0.5	-2.2	-1.5	2.5	3.3	3.0	3.6	3.8
23.MARG PROPENSITY TO SAVE (CONSTANT)	30.5	2.2	-168.0	59.5	-9.9	20.9	..	..	..
24.TERMS OF TRADE ADJ./GDP (CONSTANT)	0.4	0.2	0.0	1.3	-0.7	-0.1	..	..	..
25.ICOR (CONSTANT)	5.6	11.2	32.4	-4.0	-4.2	5.7	7.9	..	..

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ARGENTINA

	HISTORIC DATA		REFERENCE YEAR	RECENT DATA		EST. DATA		PROJ.DATA	
	1960-1973	1973-1980	1980	1981	1982	1983	1984	1985	1986
TRADE AND BALANCE OF PAYMENTS						**RATIOS**			
26.SHARE OF MANUF IN EXPORTS (CUR)(1)	12.6	24.2	23.2	19.7	24.2	17.3	18.5	19.9	..
27.IMPORT GDP ELASTICITY	0.7	4.9	57.6	0.6	8.1	-1.5	1.4	*	1.2
28.CUR ACCT BALANCE/GDP (CURRENT)(3)	0.1	-0.6	-8.8	-8.0	-4.1	-3.4	..	..	..
29.RESERVES IN MONTHS OF IMPORTS OF GOODS AND SERVICES(3)	3.9	8.1	7.0	3.7	4.5	2.8	2.5	..	..
DEBT INDICATORS (4)									
30.LT DEBT SERVICE TO EXPORTS RATIO	45.2	30.4	29.5	33.8	38.6	42.8	34.3	34.5	..
31.LT INT. SERVICE TO EXPORTS RATIO	14.6	10.8	12.9	17.3	25.0	30.8	27.2	24.2	..
32.LT DEBT SERVICE TO GNP RATIO	4.6	4.8	5.9	6.6	6.1	5.5	..	..	..
33.DOD. LT PUB DEBT AT VIR/ DOD. TOTAL LT PUB DEBT	4.5	39.5	57.1	59.4	64.9	80.0	..	..	..
34.NET TRANSFERS/TOTAL DISB	-10.4	25.1	29.9	52.1	21.1	-74.8	-39.6	19.5	..
35.WORLD BANK DEBT/TOTAL LT DEBT	..	..	2.4	2.1	1.9	1.5	1.4	1.7	..
MONETARY INDICATORS (CURRENT)									
36.CHG IN CLMS GOV/GOV BUDGET BAL	..	..	..	..	..	..	..	..	..
37.CLMS GOV/CLMS PRIV SECT(6)	35.3	19.6	18.4	37.7	37.2	67.9	..	..	..
38.MONEY SUPPLY/GDP	25.7	29.4	29.2	32.6	30.5	30.6	..	..	..
GOVERNMENT ACCT (CURRENT)									
39.DIRECT TAXES/GDP(5)	4.6	6.0	6.4	4.1	3.5	..	..	..	..
40.TOTAL REVENUE/GDP(5)	13.2	16.9	17.4	17.2	15.5	..	..	..	..
41.GOV. BUDGET BALANCE/GDP(5)	-3.9	-3.3	-3.6	-8.2	-7.0	..	..	..	..
42.PUBLIC/TOTAL CONSUMPTION	13.3	17.5	19.0	16.4	14.9	14.9	..	..	..

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NOTE: ALL REFERENCE YEAR VALUE DATA IN US$ 1980 MILLIONS, EXCEPT PER CAP TOTAL CONSUMPTION WHICH IS IN US$.

LEGEND:
.. INDICATES NOT AVAILABLE
M INDICATES DATA IN MILLIONS
* INDICATES INFINITE

FOOTNOTES:

(1) SERIES STARTS IN 1962.
(2) US$/LOCAL CURRENCY. SERIES STARTS IN 1979. INCREASES INDICATE APPRECIATION; DECREASES INDICATE DEPRECIATION.
(3) SERIES STARTS IN 1965.
(4) SERIES STARTS IN 1970; STOCK AND DEBT SERVICE PAYMENTS ARE BASED ON PROJECTED CONTRACTUAL OBLIGATIONS AT END 1983 PLUS ESTIMATED NEW COMMITMENTS IN 1984-86. FLOWS ARE NET OF RE-SCHEDULING TRANSACTIONS.
(5) SERIES STARTS IN 1970.
(6) SERIES STARTS IN 1966.

MANAGEMENT SUPPLEMENT
SAVEM TABLES
SELECTED DEBT INDICATORS
1975-1985

ARGENTINA

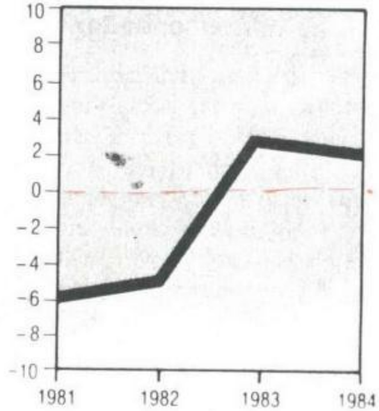
	1975	1980	1981	1982	1983	1984	1985
I. VALUES (in current US$, billions) /a							
1. Long-Term Debt (LT)	6.58	16.79	22.76	27.11	35.47	38.20	43.50 /b
2. Short-Term (ST)	..	10.53	10.98	14.46	8.22	8.50	5.00
3. Total Debt (DOD)	6.58	27.32	33.74	41.57	43.69	46.70	48.50
4. Interest (INT) /c	0.49	2.66	3.80	4.13	4.44	3.87	3.26
5. Amortization	0.97	1.86	1.95	1.32	1.40	0.73	1.10
6. XGS, (nominal)	3.59	11.20	11.82	9.73	9.76	10.16	10.74
II. RATIOS (percent)							
7. DOD/XGS	183.4	243.9	285.3	427.4	447.6	459.6	451.6
8. TDS/XGS	40.9	40.3	48.7	56.0	59.8	45.3	40.6
9. INT/XGS	13.8	23.8	32.2	42.4	45.5	38.1	30.3
III. GROWTH RATES (nominal)							
10. DOD (% change)	-1.9	30.4	23.5	23.2	5.1	6.9	3.9
IV. VULNERABILITY COEFFICIENTS							
11. VIR/DOD (%)	42.5	75.6	74.6	77.1	80.0	85.0	85.0
12. Concessional/DOD (%)	3.0	1.4	1.0	0.9	0.8	0.6	0.5
13. Preferred Creditors/DOD (%)	9.2	4.0	3.6	3.2	3.2	3.4	3.4
14. Average Cost of Funds (%)	7.4	11.0	12.5	11.0	10.4	8.6	6.8
15. ST/DOD (%)	..	38.5	32.5	34.8	18.8	18.2	10.3
16. Average Maturity (yrs)	11.3	5.4	9.5	7.3	7.5	7.4	8.3 /d
Memorandum Item:							
Use of IMF Credit (in US$, millions)	292.8	0.0	0.0	0.0	1173.2	1098.4	..
Service Charges:					74.2	89.6	87.2
(Repurchases)					0.0	0.0	0.0
(Charges)					74.2	89.6	87.2

a. Data after 1982 are estimates since detailed loan-by-loan data are not available; flows are net of rescheduling transactions.
b. Includes refinancing of short-term into long-term debt and capitalization of interest in arrears.
c. Estimated actual payments. These differ from CPP estimates which are on an accrual basis as reported by the Government of Argentina.
d. Assumes rescheduling and the associated lengthening of maturities.

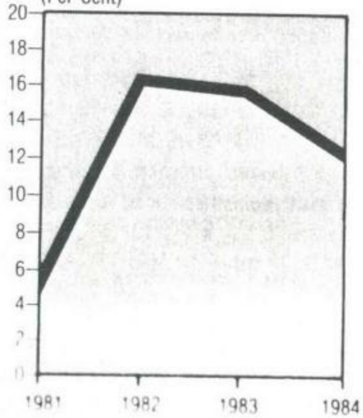
Argentina

Economic Indicators

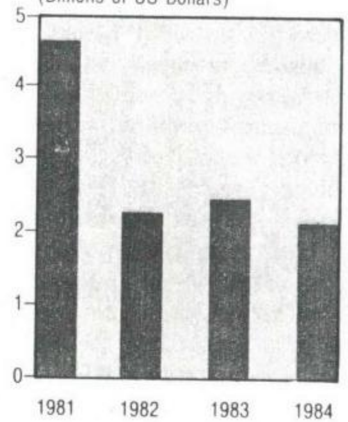
Growth of Gross Domestic Product
(Per Cent)



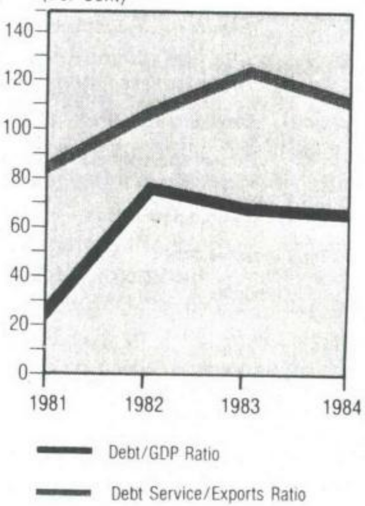
Overall Deficit of the Public Sector Relative to GDP
(Per Cent)



Balance of Payments: Current Account Deficit
(Billions of US Dollars)



Total External Debt
(Per Cent)



Statistical Profile*·

Area (Km²)	*2,776,656*
Population: Total 1984 (83.3% urban)	*30,097,000*
Annual growth rate 1970–84	*1.7*
Birth rate (1984)	*24.6*
General mortality (1984)	*8.7*
Infant mortality (1984)	*36.0*
Life expectancy (1984)	*69.7*
Literacy (1982)	*94.2*
Labor force by sector (1980)	(Percentages)
Agriculture	*15.2*
Mining	*0.5*
Manufacturing	*21.0*
Construction	*8.8*
Others	*54.5*

	1982	**1983**	**1984****
Real production		(Growth rates)	
Total GDP (market prices)	−5.1	2.9	2.0
Agricultural sector[1]	7.3	0.7	2.6
Mining sector[1]	−0.7	3.2	−0.9
Manufacturing sector[1]	−4.7	10.9	4.3
Construction sector[1]	−19.8	−6.8	−20.7
Public Sector		(Percentages of GDP)	
Current revenues[2]	32.5	34.2	33.1
Current expenditures	40.8	41.1	38.3
Current savings	−8.3	−6.9	−5.2
Capital expenditures	8.3	8.8	7.2
Deficit or surplus	−16.6	−15.7	−12.4
Domestic financing	13.5	15.6	11.7
Money and prices		(Growth rates)	
Consumer prices	164.8	343.8	626.7
Money supply	247.5	362.0	626.6
Domestic credit	224.0	400.8	565.7
Public	204.8	670.7	549.5
Private	230.8	308.9	576.1
Exchange rate, average (units of national currency per dollar)	2.59	10.53	67.65
Balance of payments		(Millions of dollars)	
Merchandise exports (FOB)	7,157	7,834	8,701
Merchandise imports (FOB)	4,573	4,123	4,199
Merchandise balance	2,583	3,711	4,502
Net services	−4,858	−6,166	−6,655
Current account balance	−2,241	−2,439	−2,154
Official capital	2,488	289	708
Private capital	−1,089	−235	2,310
Change in net reserves (− increase)	641	2,473	−617
Total external debt		(Millions of dollars)	
Total	n.a.	n.a.	n.a.
Disbursed	43,634	45,071	48,000
Debt service (interest and amortization)	9,202	11,546	12,324
		(Percentages)	
Debt service coefficient	107.7	127.0	116.8
Interest coefficient	56.8	58.2	54.5

* Where necessary, the items of information presented in this table are defined in the list of sources appearing on page 183. Any clarification or interpretation of the data should be referred directly to the pertinent source.
** Preliminary estimate.
[1] At factor cost. [2] Includes capital revenue.
n.a. Not available

Argentina

Recent Economic Trends

The distinguishing features of the Argentine economy in 1984 were a continuation during the first half of the year of the trends engendered by the moderate recovery in 1983, then a period of transition, and, in the latter part of the year, the beginning of a process of internal adjustment based on an economic stabilization plan. The background to this process was a marked acceleration of inflation, monetary disequilibrium, fiscal imbalance (although it has improved somewhat since), and difficulties with the payment of the external debt service.

In these circumstances, the real gross domestic product (GDP) grew by about 2 per cent in 1984 compared with 2.9 per cent in the previous year, and an average annual fall of 5.6 per cent in 1981–82. As a result of good weather and abundant harvests, the agricultural sector expanded 2.6 per cent. After expanding 11 per cent in 1983, manufacturing continued to grow moderately in response to the virtual elimination of imports that competed with national production. These developments were reflected in greater use of the idle installed capacity of the benefited enterprises, although the level of industrial output was still 15 per cent below that achieved in 1974. On the other hand, the construction industry again contracted appreciably, and the financial sector was distorted by increasing speculation.

On the domestic demand side, the improvement in real wages and salaries, together with the expectation of a high rate of inflation, led to an increase in the level of consumption, especially of durable goods. However, investment, especially the gross fixed capital formation of the private sector, continued to be depressed; should that trend continue, it could adversely affect the future development of productive activities.

In the external area, the efforts of the Government to keep the exchange rate at a level that would make Argentina's exports competitive produced a surplus in the merchandise balance that far surpassed expectations, since exports were up 11 per cent from the previous year. As a result of the continuation of quantitative restrictions, imports were held to the low level of the previous year. Nevertheless, large service payments, especially debt interest—which came to represent around 60 per cent of the value of merchandise exports and non factor services—produced a current account deficit of approximately $2.1 billion, slightly lower than in the previous year.

The external debt is the central problem of Argentina's economic crisis. More than 50 per cent of the balance of the total debt, which at year-end 1984 amounted to approximately $48 billion, falls due in 1985. About 60 per cent of the obligations payable in that year represent public sector debt. Since the service on that debt was not financially viable, negotiations for refinancing it had to be opened at a time when the economic situation of the country was becoming critical. Only at the end of 1984 and the beginning of 1985 were the authorities able to agree on a debt refinancing plan with international private banks and bilateral creditors, in the framework of the Stand-by Arrangement signed with the International Monetary Fund (IMF). However, because of the partial abandonment of the economic adjustment process in the first quarter of 1985 and failure to achieve some of the goals established, disbursements of the second tranche of the stand-by credit were suspended in late March 1985. That suspension caused uncertainty about the implementation of the external debt refinancing program, which is conditional upon the execution of the financial program with the IMF.

Despite the efforts made in 1984 to reduce the high rate of inflation by controlling prices and adopting measures aimed at improving the financial position of the public sector and moderating monetary expansion, the authorities were unable to halt the spiraling growth of prices. That acceleration was due to the strong impetus given to demand by the increase in real wages and overspending by the public sector. To these factors were added certain supply rigidities, for example of meat, and especially high inflationary expectations. Thus, the monthly inflationary rate, which fell to 12.5 per cent in January 1984, accelerated to a monthly rate of between 17 and 27 per cent during the rest of the year, and the average annual growth rate of inflation amounted to 627 per cent compared with 344 per cent in 1983. Since from February 1984 onwards the inflationary rate exceeded the expectations of the Government, real interest rates were negative.

As regards public finances, the efforts of the Government to contain the high fiscal deficit were reflected in a lowering of the expenditure level. The most drastic reductions were in purchases of goods and non-personal services and in investment outlays. There was also a sharp cutback in transfer payments from the Central Government to public enterprises and the provinces. Total revenue remained at the level of the previous year, despite the adoption of tax measures, such as the additional tax on wages and a larger employer contribution to social security, and increases in fuel prices. However, the additional revenue produced by these measures was offset by the fall in the receipts of other taxes such as the value added tax. Therefore, the tight expenditure measures adopted at the beginning of the year had to be strengthened later on. Those measures and, beginning in 1983, the transfer of the cost of the interest on the internal debt to the Central Bank accounts, succeeded in reducing the deficit of the non-financial public sector from the equivalent of 16 per cent of GDP in 1983 to an estimated 12 per cent in 1984.

The results of these fiscal efforts, however, were not paralleled by the performance of the monetary aggregates, as is shown, on the one hand, by the above-mentioned distortion of the financial system and, on the other, by a less restrictive monetary policy, which was incompatible with the other measures.

This trend was reversed only at the end of 1984 when the rate of monetary growth declined. This decline, however, affected the cost of credit to the private sector since the limited financial resources available were largely absorbed by the public sector.

Economic Policies

The Constitutional Government that took office in late 1983 faced an extremely difficult economic situation. In view of the marked internal and external disequilibria, economic policy was initially aimed at reestablishing domestic confidence. To that end, efforts were made simultaneously to lower the high rate of inflation, reactivate the productive sectors, improve real wages, reduce the public sector deficit, and strengthen the external sector.

To begin with, the Government adopted an "incomes policy" that consisted in strengthening the price control instituted in 1982, and was essentially based on price-fixing agreements with the most important enterprises in the industrial sector. At the same time, it endeavored to improve real wages through monthly retroactive adjustments in the legal minimum wage levels.

To lower the public sector deficit, the Central Government took steps to reduce spending by imposing a limit on Central Bank credits for financing the budget. It also froze vacant positions and reduced transfer payments to public enterprises and the provinces. In addition, it reallocated resources to such social sectors as health, housing, and education from non-essential defense and security items. On the revenue side, it levied on employers additional taxes of 5 per cent on wages and increased their social security contribution by 7.5 per cent. Furthermore, fuel prices were raised by 70 per cent in real terms.

The exchange policy followed in the external sector was one of successive devaluations based on the expected rate of inflation, which, when it differed from the real rate, produced a slight exchange lag, particularly in the first eight months of the year. At the same time, quantitative restrictions were imposed on imports, which largely reduced the relative openness of the economy in earlier years.

In September 1984, after lengthy and arduous negotiations the Government submitted a memorandum of understanding to the IMF with a view to obtaining from that institution a stand-by credit agreement that was conditional upon the execution of an economic stabilization program.

On the basis of that agreement, the national authorities announced, in December 1984, a short-term economic program for 1984–85 that was basically aimed at the international financial community. The objectives of that program included, *inter alia*, substantial reductions in the fiscal deficit and the inflation rate, and an adjustment of the external sector compatible with the refinancing of the external debt. Also proposed was a moderate increase in GDP and the maintenance of real wages. Thus, the goal was to reduce the inflation rate to 300 per cent for the year ending September 1985, and to an annual rate of approximately 150 per cent during the final quarter of the year. The deficit of the non-financial public sector was to be lowered to the equivalent of 8.1 per cent of GDP in 1984 and to 5.4 per cent in 1985. In addition, the deficit on current account of the balance of payments was to be slightly reduced, primarily by an improvement in the trade account. In addition, limits were fixed for the growth of the external debt, and a refinancing proposal was submitted to the creditors of the debt due since April 1982, and of that maturing up to December 1985. As it was, a credit in the amount of $4.2 billion was obtained from the international private banks for covering the external gap, and payments for the amortization of public and private debt totaling $13.4 billion were rescheduled. In addition, an agreement was concluded with the Paris Club for refinancing $2.1 billion in bilateral debts with governments.

Subsequently, in January 1985, the Government announced the main targets of a medium-term strategy of economic growth for 1985–89. The goal of that strategy was an average real GDP growth of 3.6 per cent annually between 1986 and 1989 as a result of the expansion of the external sector, both of exports and imports, and an increase in the share of investment relative to consumption. To obtain trade surpluses that can cover the payment of debt interest and finance the necessary imports of intermediate and capital goods for improving the efficiency of the productive sectors, investment will be directed towards sectors that generate foreign exchange

However, the suspension of the Stand-by Arrangement with the IMF in late March 1985 led to a new round of negotiations designed to safeguard the refinancing of the external debt described above.

Outlook[1]

The economic stabilization program entails the adoption of a strict fiscal and monetary discipline and the achievement of a larger trade surplus. In the present economic circumstances of the country this means, at least in the short term, a further reduction in public investment outlays and the continuation of import restrictions. Therefore, the prospects for economic growth in 1985 are less promising.

Furthermore, the slowing of the high rate of inflation will require a substantial reduction in the rate of increase of costs, which will also help produce a more favorable environment for reducing inflationary expectations. However, in the first four months of 1985, inflation has been much higher than expected. Consequently, despite the efforts being made to reduce inflation in the rest of the year, its level will be higher than the target established in the economic adjustment program.

In turn, short-term economic prospects will be determined by the satisfactory conclusion of agreements for refinancing the external debt, since by itself the trade surplus will not permit the country to meet its existing debt service obligations.

Despite the short-term difficulties, the Argentine economy has many important features that make its medium and long-term growth potential promising. The country is endowed with skilled human resources and a wide range of natural resources, is self-sufficent in energy, and has a food surplus. It also has a well-diversified industrial base. Consequently, it is not so vulnerable to adverse external effects, that is, it can generate larger export surpluses without having to significantly compress domestic consumption.

The five-year development plan for 1985–89 considers investment and external trade the motors of economic growth. However, a rise in investment is to some extent dependent upon a reduction in the high rate of inflation. On the other hand, even if the process of refinancing the external debt is successfully concluded, sustained export growth and access to international capital markets are essential if external equilibrium is to be reestablished.

[1] On June 14, 1985, while this report was in production, the Government of Argentina announced a stringent economic stabilization plan designed to contain inflation, which amounted to approximately 1000 per cent annually in May 1985. The measures announced are drastic and cover the following main aspects: (a) a freeze on prices and wages for an indefinite period; (b) monetary reform and the issue of a new monetary unit, the "austral", whose parity is fixed at 0.80 australes to the dollar; (c) a reduction in the regulated nominal interest rate, to 4 per cent a month on deposits and 6 per cent a month on loans; (d) a steep decrease in the public sector deficit, to the equivalent of 2.5 per cent of GDP in the second half of 1985 (from around 10 per cent of GDP in the first half) through expenditure control and self-financing of expenditure (with taxes and rates) and financing with external, not with domestic credits. The impact of these measures will be more clearly visible in the months ahead, and will probably alter both the short-term and the long-term prospects of the Argentine economy.

Sources of Data in the Statistical Profile:

Area:
Organization of American States, *América en Cifras 1972—Situación Demográfica: Estado y Movimiento de la Población.*

Population:
The information for the following items was furnished to the IDB by Instituto Nacional de Estadística y Censos (INDEC), February 1985:
- Total
- Birth Rate (per one thousand inhabitants)
- General Mortality Rate (per one thousand inhabitants)
- Infant Mortality Rate (per one thousand live births)
- Years of Life Expectancy
- Literacy Rate

Labor Force:
PREALC, International Labor Office, *Mercado del Trabajo en Cifras, 1950–80.*

Real GDP:
1982: Information furnished to the IDB by the Banco Central de la República Argentina, October 1984.
1983–84: Information furnished to the IDB by the Banco Central de la República Argentina, March 1985.

Public Sector:
Information furnished to the IDB by the Ministerio de Economía and the Banco Central de la República Argentina, January, 1985.

Money and Prices:
Information furnished to the IDB by the Ministerio de Economía, January 1985.

Exchange Rate:
International Monetary Fund, *International Financial Statistics*, March 1985.

Balance of Payments:

1982–83: International Monetary Fund, *Balance of Payments Statistics*, (magnetic tapes).

1984: Information furnished to the IDB by the Banco Central de la República Argentina, December 1984.

Total External Debt:

The information for the following items was furnished to the IDB by the Banco Central de la República Argentina, January 1985, except 1984 data which were estimated by the IDB:

- Disbursed debt
- Debt-service (interest and amortization)
  - Debt-service ratio
  - Debt-interest ratio

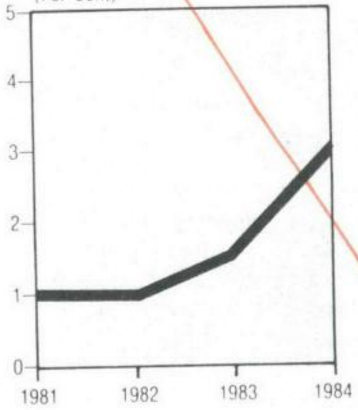
Debt-service (interest and amortization) as percentage of exports and goods and non-factor services

Interest as percentage of exports of goods and non-factor services.

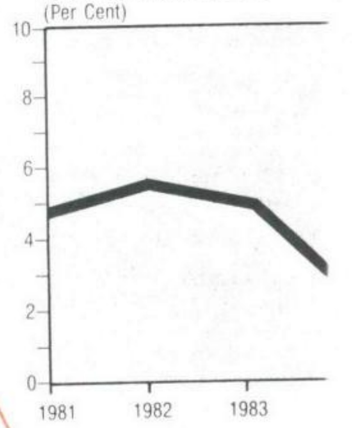
Bahamas

Economic Indicators

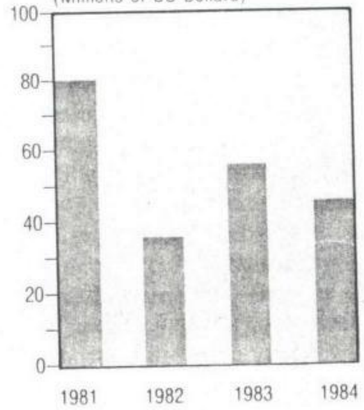
Growth of Gross Domestic Product
(Per Cent)



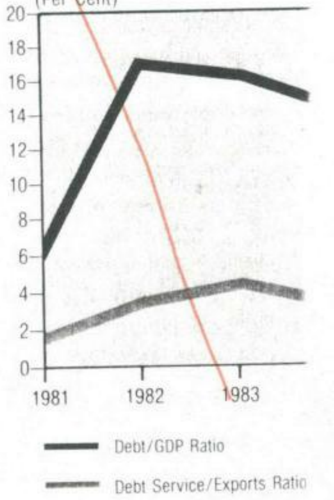
Overall Deficit of the Central Government Relative to GDP
(Per Cent)



Balance of Payments: Current Account Deficit
(Millions of US Dollars)



External Public Debt
(Per Cent)



→ Argentina RB.   AC cc: SES AF

June 11, 1986

NOTE

Vinod:

Re: Status of Medium Term Adjustment Paper

I would like to keep you posted on progress, or lack thereof, in our recent discussions with the Argentine Government.

The Government agrees with the thrust and sequence of the reforms we have proposed in the Medium Term Adjustment Paper. While it will use the Bank's paper as a basis for its strategy, the Government wants to present a version to the commercial banks that takes appropriate account of the political dimension and has the clear imprimatur of the Administration. A draft exists but has not been judged satisfactory by Mr. Canitrot, the Deputy Minister of Economy, who intends to take a direct hand in rewriting it. He recognizes that delays have occurred; he explained that they are a consequence of the heavy involvement of senior officials in the budget and external debt discussions in Congress and in wage and price negotiations with the labor unions and industrial federations. Mr. Canitrot mentioned in our discussions that he wants to give greater specificity to some of the reform initiatives for the trade regime, the financial sector and privatization, and to put them in more of an operational context. This would require further discussions within the Government, and with the respective domestic interest groups to ensure that the document had broad internal support before it was presented to the commercial banks.

Messrs. Canitrot and Brodersohn (the Secretary of Finance) made it clear that the Government intended to approach the commercial banks immediately after it had agreed with the Fund on a Letter of Intent for a Stand-by (probably 18 months'). Government officials expect that an agreement could be reached by mid-July. We again emphasized that it would be very important to have some reform initiatives already in place before approaching the banks; this would enhance the Government's credibility and make a convincing case for additional borrowing. Government officials agree; they want to make a well orchestrated presentation in which the Bank would play a major role. They also confirmed that the Government would discuss the paper with the Bank before presenting it to the public and the commercial banks.

Peter R. Scherer

cc: Mr. Sokol

→ Argentina BB.

Fundación Mediterránea NEWS LETTER

Vol. 1, Nº 1 - Argentina - Jan - Mar 1986

Recent changes in the Argentine Economy

Inflation, which has been a pervasive phenomenon in Argentina for many years, accelerated rapidly in the first semester of 1985. Simultaneously, uncertainty was growing and the level of activity was declining. June's 30% monthly inflation rate is a good indicator of how close the economy was to hyperinflation.

A New Stabilization Program

On June 14, 1985 the government decided to give a shock treatment to inflation. A stabilization program to reduce "inertial" inflation and cut down the fiscal deficit was put into practice.

A few days before launching the program the government devalued the peso and took measures to correct relative prices, in particular the prices of meat which is an important component of the worker's basket and an important factor in determining inflation expectations. The program also included the adoption of a fixed exchange rate and a freeze on both prices and salaries.

An announcement was made that the total public sector deficit was to be reduced from 13.1 to 2.5% of GDP. This remaining deficit was to be entirely financed by external loans. The government made a commitment not to issue money to finance the fiscal deficit. A new monetary unit was adopted, the austral (₳) equivalent to 1,000 pesos and controlled interest rates were reduced from levels of approximately 30% per month to 6% per month.

To remove the inflationary pressures so ingrained in the economy and to contribute to change expectations, all written contracts were to be changed at maturity from pesos into australes and a conversion factor, which decreases every day on a given schedule, was to be applied. This procedure, popularly known as "desagio", was introduced to eliminate from the contracts already in execution the compensation for the expected rate of inflation foreseen at the time of the signing of those contracts. As inflation was to be unexpectedly reduced, fairness and the need to break "inertial" inflation needed a reduction in nominal terms in the financial charges implicit in each contract.

The Price Freeze

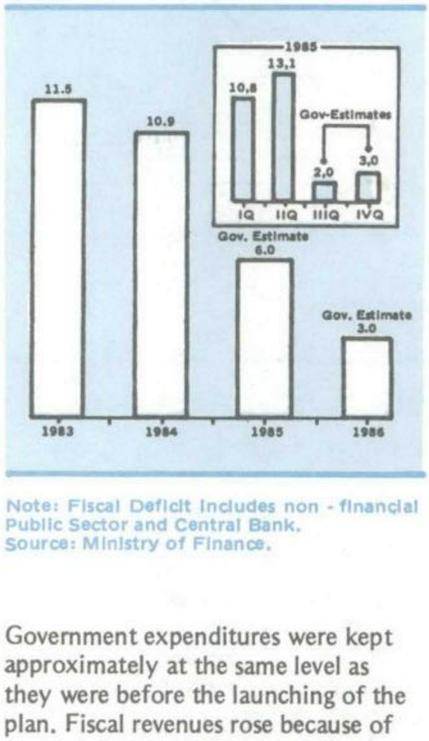
The price freeze was enforced both at the producer's and at the retailer's level. The control of these prices is carried out by specific offices in each province, which process consumer complaints and inspect retail shops to check compliance. Although lists may differ from province to province, controlled prices at the retailer's level include some items such as food and some standard clothes. At the same time, the government also imposed a freeze on public utility rates and prices.

While compliance has not been uniform, the implementation of the freeze has not encountered serious problems; except for a few bottlenecks. Uncertainty as well as financial costs were reduced by the plan without affecting profitability. Authorities established reasonable ceilings for most prices and showed some flexibility in granting adjustments for the most evident cases in which prices did not cover costs.

The Fiscal Deficit

A substantial reduction in the fiscal deficit has been made through an increase in revenues. (see Chart 1).

Chart 1.
Fiscal Déficit goes down (as a percentage of G.D.P.)



Note: Fiscal Deficit includes non - financial Public Sector and Central Bank.
Source: Ministry of Finance.

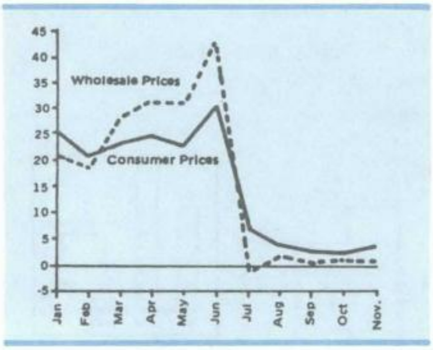
Government expenditures were kept approximately at the same level as they were before the launching of the plan. Fiscal revenues rose because of increased taxes on foreign trade and on oil derivatives as well as from a reduction in the cost of the fiscal lag. As inflation went down, the loss of real tax collection that comes from the difference between the timing of tax accrual and tax collection was reduced.

Before launching the stabilization program, 40% of the total deficit had come from the Central Bank, due to the use of interest-bearing instruments of monetary control.Although the deficit of the Central Bank was reduced substantially because of the change in controlled interest rates, this deficit has remained somewhat larger than planned.

Five Months later

To a substantial extent, the plan succeeded in bringing down inflation. The inflation rate computed from the official cost of living index was 6% in July. In the following months, it kept going down till it reached 1.9% in October. In november, the inflation rate was still low, but a bit higher than the previous month reaching 2.4% (see Chart 2). However stabilization has not been firmly established yet, since underlying inflationary forces such as salary pressures, changes in relative prices, and fiscal deficit are still present.

Chart 2.
Drastic reduction in the rates of inflation (Monthly percent changes 1985).



Source: National Statistical Institute, INDEC

The level of activity has remained low: the index of industrial production shows that the economy was in October 10% below the level attained in the same period of 1984. Unemployment and underemployment are high compared with 1984 levels. But signs of a mild recovery have already surfaced. The index of industrial production, for example, indicates a turning point in August with a very modest upward movement continuing in September and October.

Industrial wages which declined all along 1985 deteriorated even further after the plan was implemented, and were in October 20% below the level attained in December, 1984. The decline in real salaries is even higher in the public sector and in construction. Labor unrest has increased, but divisions in the opposition party of which organized labor is part, have weakened the labor demand for higher salaries. Labor leaders, in essence, are more concerned with employment than with salaries.

Monetary policy has been tight and, consequently, interest rates have remained high in real terms (the effective rate has been around 40% per year). The total fiscal deficit was reduced from the level of 13.1% of GDP in June to approximately 5% in the third quarter of 1985. The Central Government's deficit appears to be under control and could be lower than projected, but the Central Bank's deficit, as mentioned above, is substantially higher than planned. An increase in the demand for financial assets dampened the inflationary pressures that said deficit could have caused.

In the near future no major changes are foreseen. Prices are expected to increase at moderate rates. The expansion of the economy will be, at best, very modest not only because of a tight monetary policy but also because of the uncertainties related to the price setting mechanism which will replace the price freeze. The fall in Argentine export prices may reduce the trade balance surplus, which will probably make the balance of payment targets difficult to reach in 1986.

6th. Latin American Meeting of the Econometric Society - 1986

Dr. Domingo Cavallo, director of IEERAL, was appointed as Chairman of the Organizing Committee for the 6th Latin-American Meeting of the Econometric Society, which will take place on July 22-25, 1986. This is the second time the regional meeting is held in Argentina and the first in the province of Córdoba.

The meetings are open, as in the past, to all economists and econometricians, including those who are not currently members of the Econometric Society.

The deadline for the submission of the abstracts is January 30th, 1986 and for the final papers April 30 th, 1986.

The program will include contributions and special invitations in economics and econometrics, both theoretical and applied.

Further information may be obtained from:

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President Organizing Committee
Juan del Campillo 394
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SELECTED ABSTRACT

A Modification of ALADI Monetary Convention.

Aldo A. Dadone and Carlos V. Kesman
Estudios Nº 30, Vol 7, Apr.-Jun 1984

A newly elaborated proposal destined to radically change the attitude of the member countries in ALADI commercial negotiations is analyzed in this paper. Should this idea be implemented, each country would be highly motivated to buy goods and services from its partners in the Agreement.

In order to understand the modification proposed here, it is important to briefly describe the current functioning of the system. There are several bilateral lines of credit among the countries, and every four months multilateral compensations of the balances of these credits are realized. This tri-annual compensation implies currency payment of the balances.

The system has grown rapidly: the amount of dollars negotiated through the Convention surged from $ 106 million in 1966 to 9.3 billion in 1981. With the subsequent debt crisis this value dropped substantially mainly due to the attitude adopted by the majority of the member countries, which attempted to restrict imports and increase exports; in some cases even removing exports from the Convention. Their intention was to obtain currencies with which to pay their debts; this, however, did not take place being the majority of the countries greatly in debt there were no large holdings of dollars in the region. The measures taken only achieved a reduction in the intra-regional commerce as well as in the convention transactions.

In response to this situation, a Monetary Agreement for ALADI has been proposed. The Agreement contains three central mechanisms: a) a Multilateral Compensatory Chamber, b) a Latin-American Monetary Unit (LAMU), and c) a Financial Cooperation Fund.

The most important change of this proposal with respect to the current functioning of the system is that part of the resulting balance differences could be paid with a money (the LAMU) distributed among the member countries. These original LAMU holdings will be balanced on an annual basis: the countries that possess fewer LAMUs than their initially alloted quantities will have to make purchases from those which accumulated an excess of LAMUs.

The payment will be made in dollars and other currencies. In order to overcome the difficulties a country may have in paying its annual balances, that country could resort to credit lines of the Financial Cooperation Fund. The Fund will grant succesive credits on increasingly restrictive terms. This could possibly require a "Stabilization Program" to attain pre-determined levels of credit assistance.

The modification proposed here entails a change in the attitude mentioned above. It is fundamental that ALADI member countries recognize the impossibility of obtaining large balances of commonly accepted currencies from the intra-regional exchange.

A multi-lateral reciprocal credit will be granted through the distribution of LAMUs (which will be inconvertible into hard currencies).

ALADI's INTRA–ZONE EXPORTS. in billion dollars

Period	Actual values	Estimated Trend
1970	1.2	1.2
1971	1.4	1.5
1972	1.6	1.9
1973	2.3	2.3
1974	3.9	2.9
1975	4.0	3.6
1976	4.6	4.5
1977	5.7	5.6
1978	5.9	7.0
1979	8.7	8.7
1980	10.9	10.8
1981	11.6	13.5
1982	10.0	16.7
1983	7.1	20.8
1984	8.1	24.9

Source: ALADI. General Secretary. Years 1970-1979 - INTAL: "Estadísticas del Intercambio Comerc. de los Países Latinoamericanos 1980-84".

Each country will be obliged to accept the LAMUs up to an amount of 100% above the original allotment. The null cost and the inconvertibility of the LAMUs with respect to other currencies will induce to spend the LAMUs quickly. The effect of the initial stock of currencies received will then be diluted in the subsequent commercial flow, since all the countries will try to spend the LAMUs by buying goods and services from one another.

A fundamental aspect of the system is that the private operators (exporters, importers, and bankers) of each country will know on a daily basis the LAMU balances of all the other member countries. In this way they will be aware of the capacity and the interest of each central bank to operate in LAMUs. When a country has low reserves of LAMUs its foreign importers and national exporters will be motivated to trade. Similarly, when a country has a level of LAMU close to its maximum limit, its national importers and foreign exporters will pursue commercial negotiations. In all such instances the banks will be interested in promoting these operations and in publicizing possible opportunities among its clients.

If the only restriction to the acceptance of LAMU were the proposed limit of 200% over the original allotment, the payment schedules of the foreign debts will be endangered by receiving LAMUs in payment for exports instead of normal currencies, or by receiving exports with imported parts. Therefore, to avoid such inadmissible deviations, "negative lists" will be drawn up. These lists will include products for which a country will not accept automatic payment in LAMUs.

To sum up, the granting of multilateral credits through the distribution of LAMU and the dynamic effect encouraged by its use, plus the revitalization brought about by the incorporation of the private sector to this new mechanism will provide the necessary energy to launch the intra-regional commerce. Furthermore, the level of trade previously achieved will be quickly regained and projected toward a new horizon.

NOVEDADES ECONOMICAS

Novedades Económicas, published monthly by Fundación Mediterránea - IEERAL, presents non-technical analysis of current economic conditions and short articles on major Argentine issues. The periodical contains special sections devoted to the study of the main economic regions of the country where the Fundacion offices are located, A statistical section presents updated information on international price comparisons for selected goods and purchasing-parity estimates of the Argentine currency in terms of the currencies of both industrialized and developing Latin-American countries.

The issues included in the editions of October, November and December of 1985 are the following:

Volume 7, Nº 58 - October 1985

- The Plan Austral gets ground
- Monetary and fiscal targets three months after the launching of the Plan Austral
- Unequal effects of the Argentinian Uruguayan commercial agreement
- Livestock: toward a redimensioning of the stock?
- The dollar's drop improves Argentinian position

Volume 7, Nº 59 - November 1985

- The dangers faced by the Plan Austral
- How should the Argentinian exchange market be organized?
- Integration of regional and national economic policies. The case of the viticultural sector
- Toward a new investment plan for the electricity sector
- The key to growth is improved investments

Volume 7, Nº 60 - December 1985

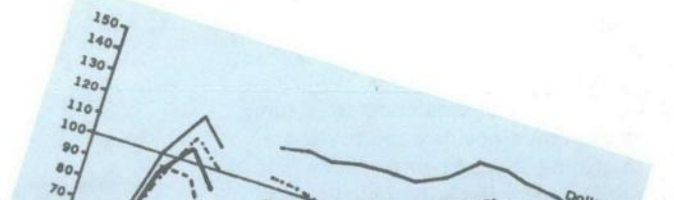
- Argentinian economy in 1986
- Stability and growth in Argentina
- Do the air-transport regulations benefit the provinces?
- The economic effects of the floods
- Tea home market: increase of general welfare due to the interaction between national production and imports.

Other issues of Novedades Económicas
Regional Economies
Evolution of the Real Exchange Rate
International price comparison
Institutional news

Real Exchange Rate.[a/] December 1976 = 100
Foreign currencies against argentine monetary unit (Austral).

Period	Average b/	Dollar	Cruzei-ro	Lira	D-Mark	Yen
1980	43	39	35	46	44	45
1981	49	50	51	52	40	51
1982	90	99	94	85	72	87
1983	105	121	92	105	86	111
1984	90	111	75	88	70	100
'84 Nov.	93	118	78	88	70	104
Dec	94	120	81	89	69	103
'85 Jan.	90	119	69	87	67	100
Feb	90	121	74	85	65	98
Mar	91	121	72	85	66	98
Apr	93	120	70	89	69	101
May	98	127	72	95	74	108
Jun	108	139	80	104	81	119
Jul	112	139	82	107	85	123
Aug	110	135	83	106	85	119
Sep	108	133	80	107	83	118
Oct	109	130	78	107	87	124
Nov	108	127	75	106	87	126

Notes: a/ Adjusted for differentials in consumer prices.
b/ Includes Dollar, Cruzeiro, Lira, D-Mark, Yen, French Franc and Peseta



Source: Own estimates from data published in Ambito Financiero, Monthly statistic of Japan, Conjuntura and Listino

Estudios

Estudios, now in its eighth year, is a quarterly journal of Fundación Mediterránea - IEERAL whose principal purpose is to present the research findings of the IEERAL staff. These studies cover a wide range of topics, but a high proportion of them are in the fields of monetary and financial policy, international trade and Latin-American integration; energy, regional development and labor economics.

This section includes abstracts of the works published in the edition of the first quarter of 1986:

International Price Comparisons Between Argentina and The United States.

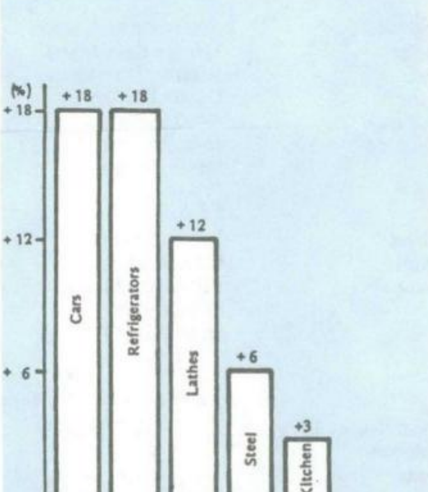
Jorge E. Fernandez Pol and Juan J. Llach.

Estudios N° 37, Vol. 9 , Jan-Mar 1986.

The purpose of this work is to compare industrial Argentine ex-work prices with those of U.S.A. and formulate hypotheses on the observed discrepancies. The period of the analysis is the third quarter of 1983, and the selected products are: cold rolled steel sheets, cars, harvesters, family refrigerators, kitchen stoves, lathes, eccentric shaft presses, bending presses, and shears.

All relative prices differences are found to be less than 20%. To explain these empirical results, the authors have formulated fifteen tentative hypotheses and they have made a qualitative evaluation of the observed spreads (that is the absolute differences between Argentine ex-work prices and U.S. ex-work prices). On the one hand, the main causes of negative spreads are dollar overvaluation and low Argentine relative labor costs. On the other, the principal cause of positive spreads are inflationary expectations.

Price Differences between Argentina and the United States. 1983 (Percentage)



Effects of Commercial Policy on the "Equilibrium" Real Rate of Exchange and on Relative Prices: The Argentine Experience: 1960-1984

Adolfo C. Sturzenegger.

Estudios N° 37, Vol. 9, Jan-Mar 1986.

This paper comments upon the effects of commercial policy on internal relative prices, on the "equilibrium" real exchange rate and on the level of its international trade, in an open economy with three sectors —exportables, importables and domestic—. Including results got in a previous work, several quantitative conclusions are obtained for the Argentine experience along 1960-1984. During this period commercial policy strongly discriminated against exportables vis a vis importables. Average export taxation was 14%, while average implicit tariff protecting importables was 61%, implying that the relation between internal terms of trade and external terms of trade between exportables and importables had an average value of 0.54 for that period. This measure means that the relative price of exportables has been almost 50% below its international relative price. This "antitrade bias" of the Argentine economy has increased during the last years. In 1984 the value of that relation is 0.42 implying a discrimination higher than 130% in favor of importables vis a vis exportables.

Taking account of the situation of the commercial policy existing in 1984 and of the equilibrium variations on the real exchange rate related to changes in that policy, this paper presents estimations of the changes in relative prices that would take place with the introduction of new schemes of commercial policy. The elimination of only export taxes (retenciones) has a minor impact on relative prices. But the elimination of both export taxes and protection to importables would imply extremely large reaccomodation of relative prices. Exportable prices would increase around 60% vis a vis domestic goods and around 130% vis a vis importables.

This situation appears as a sharp dilemma for Argentine economic policy. On one side, the high "antitrade bias" should be reduced. On the other, such reduction requires substantial changes in relative prices and so the possibility of strong resistance to accept them.

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Fundación Mediterránea is a non-profit organization presently sponsored by a large group of Argentine entrepreneurs interested in improving the study, discussion and design of Argentine economic policies. In 1977, a group of entrepreneurs from Córdoba organized Fundación Mediterranea and in 1982 entrepreneurs from Buenos Aires joined the institution. In recent years branches of the Fundación have been established in Mendoza, Posadas, Salta, and Comahue. Moreover, private firms currently support the institution: 125 as founders, 68 as full members, and 42 as adherents.

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IEERAL is also a non-profit organization, whose purpose is to carry out policy-oriented research on economic problems of Argentina and Latin-America. IEERAL maintains a staff of 13 senior economists, all of whom have received post-graduate training in leading universities; 20 economists and 6 junior economists. Half of IEERAL resources come from Fundación Mediterránea and the other half from contracts with private and public organizations as well as international institutions.

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* with a leave of absence
** visiting researcher

=> Arg. RB.

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 24, 1986

TO: Files

FROM: Vinod Dubey, Director, CPD

Vdubey

EXT.: 60061

SUBJECT: Argentina Medium-Term Growth Framework Study - Minutes of the OPSC Meeting, January 9, 1986

Present: Members: Messrs. Stern (Chairman), Burki, Dherse, Husain, Jaycox, Karaosmanoglu, Lerdau, Knox, Ohuchi, Thalwitz, Wood

Others: Messrs. Carter, Choksi, Clements, Donovan, Dubey, Gue, Huang, Jansen, Jay, Lysy, Picciotto, Scherer, Sokol, van der Tak

1. The meeting agreed with the thrust and conclusions of the paper. The paper was explicit on the implications of accelerating growth while holding the line on modest per capita consumption growth in an attempt to obtain a turning point on Argentina's debt, where repayment could be possible. The meeting concluded that once such a turning point was reached and all external payments were made without fresh borrowing, the choices available on what to do with the foreign exchange surplus should be discussed in the paper, i.e. either repay principal on pre-1986 commercial bank borrowing, increase imports with a view to accelerating growth, increase imports so as to improve consumption levels, or accumulate foreign exchange reserves and earn interest on them. The meeting agreed that the eventual repayment of the principal of the pre-1986 commercial bank borrowing be included in the projections.

2. The meeting also requested that an explanation on the limits to grow beyond 4.5-5% in real terms on a sustained basis be included in the paper, particularly since in the growth experience of Argentina over the past 50 years, though levels of 4.5-5% had been occasionally achieved, they were rarely exceeded, and have never proven to be sustainable over any length of time. More important, it was recognized that 4.5-5% real growth was fairly respectable since population grew only at about 1.5% per annum and large productivity increases would be required in the economy to make this growth possible. In this connection, one speaker indicated that Argentina is a relatively industrialized country with a mature, albeit distorted industrial structure. Consumption levels are relatively high, income distribution is not highly skewed, and most basic needs are, even in the current slump, being met. Furthermore, Argentina is also an agricultural country, dependent on foreign markets for much of its growth momentum. These same markets show only limited potential for Argentina as the century draws to a close. While it is not unreasonable to assume that for a brief period the country could achieve an

average growth of real gross domestic product in excess of 5%, particularly in response to marked improvements in efficiency, such growth, for the reasons outlined above, would not be sustainable.

3. One speaker stated that the paper provided guidance on what needs to be done, in the Bank's perception, in terms of sectoral policies to promote growth. Several speakers indicated concern for the high level of real interest rates prevailing in Argentina. However, the meeting concluded that while medium-term inflationary expectations continued and distortions in the financial system remained, real interest rates would continue to be high.

4. The meeting agreed that the next step was to discuss the paper in the Management Committee and following that with the Fund. After completing such discussions, the paper should be discussed with the Government and presented as the Bank's view of a reasonable medium-term framework and, if possible reach an agreement on the paper. Out of this would evolve a Government medium-term economic program for growth. The paper would then become the basis for discussions of medium-term financing arrangements with the financial community.

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: 2/12/86

NAME	ROOM NO.
Mr. Choksi	N-623

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

ARGENTINA--Minutes of the OPSC Meeting

Attached you will find the draft minutes. I wish to apologize for the delay. I left a draft just before I went to Argentina and in the hurry I did not send it to you. The trip went very well. We can talk whenever you have some time.

FROM: José B. Sokol José Sokol	ROOM NO.: F-925	EXTENSION: 74062

→ Arg. 13.

DRAFT

DATE: February 12, 1986

TO: Files

FROM: Vinod Dubey, Director, CPD

EXTENSION: 60061

SUBJECT: ARGENTINA--Minutes of the Operations Policy Sub-Committee Meeting on Argentina Medium-Term Growth Framework Study, January 9, 1986

Present Members: Messrs. Stern (Chairman), Burki, Dherse, Husain, Jaycox, Karosmanoglu, Lerdau, Knox, Ohuchi, Thalwitz, Wood.
Others: Messrs. Carter, Choksi, Clemens, Donovan, Dubey, Gue, Huang, Jansen, Jay, Lysy, Piccioto, Scherer, Sokol, van der Tak

1. The meeting agreed with the thrust and conclusions of the paper. It was pointed out that the paper was explicit on the implications of accelerating growth. This was combined with explicit attention to obtain a turning point on Argentina's debt, where repayment could be possible, while holding the line on modest per capita consumption growth. The meeting concluded that once the projections reach a turning point where all external payments can be made without fresh borrowing, the choices available on what to do with the surplus of foreign exchange should be discussed in the paper, i.e. repay principal on pre-1986 commercial bank borrowing, increase imports with a view to accelerating growth, increase imports so as to improve consumption levels, and accumulate foreign exchange reserves and earn interest on them. The meeeting agreed that the eventual repayment of the principal of the pre-1986 commercial bank borrowing be included in the projections.

2. The meeting also requested that an explanation on the limits to grow beyond 4.5-5% in real terms on a sustained basis be included in the paper, particularly since in the growth experience of Argentina over the past 50 years, levels of 4.5-5% had been occasionally achieved and rarely exceeded, and have never proven to be sustainable over any length of time. More important, it was recognized that 4.5-5% real growth was fairly respectable since population grew only at about 1.5% per annum and large productivity increases in excess of 3% per annum would be required in the economy to make this growth possible. In this connection, one speaker indicated that Argentina is a relatively industrialized country with a mature, albeit somewhat distorted industrial structure. Consumption levels are relatively high, income distribution is not highly skewed, and most basic needs are, even in the current slump are being met. Furthermore, Argentina is essentially an agricultural country, dependent on foreign market for much of its growth momentum. These same markets show only

limited potential for Argentina as the century draws to a close. While it is not unreasonable to assume that for a brief period the country could achieve an average growth of domestic product in excess of 5% particularly in response to marked improvements in efficiency, such growth, for the reasons outlined above would not be sustainable.

3. One speaker stated that the paper provided guidance on what needs to be done, in the Bank's perception, in terms of sectoral policies to promote growth. Several speakers indicated concern for the high level of real interest rates prevailing in Argentina. However, the meeting concluded that while medium-term inflationary expectations continued and distortions in the financial system remained, real interest rates would continue to be high.

4. The meeting agreed that the next step was to discuss the paper in the Management Committee and following that with the Fund. After completing such discussions, the paper should be discussed with the Government and presented as the Bank's view of a reasonable medium-term framework and, if possible reach an agreement on the paper. Out of this would evolve a Government medium-term economic program for growth. The paper would then become the basis for discussions of medium-term financing arrangements with the financial community.

JSokol:mac/mad

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

→ Argentina RB.

DATE: January 28, 1986

TO: Mr. Jose Sokol, Acting Division Chief, LC2AR

FROM: F. Desmond McCarthy, Sr. Economist

EXT: 76254

SUBJECT: ARGENTINA - Back-to-Office Report

1. I visited Buenos Aires between January 9 and January 20 1986 with Kutlay Ebiri to update our knowledge of the economic situation and to prepare for an economic mission scheduled to depart late March 1986.

Political Situation

2. President Alfonsin continues to enjoy popular support. The Plan Austral has now been in place since June 1985. There is a steady stream of outside visitors extolling the Plan. They included such diverse figures as Messrs. Volcker, Mulford, Galbraith, Clausen and during our trip Messrs. Draper, Rockefeller and Kennedy. One effect of the laudatory comments of these influential visitors has been to raise expectations for more tangible assistance from the outside especially now as the Plan Austral moves to its expected growth phase. Domestically there is satisfaction with a number of outcomes of the Plan to date, in partiuclar the fall in inflation from near hyperinflation rates of 25% per month in May 1985 to close to 2% in the last quarter of 1986. However, there is also increasing dissatisfaction among significant segments of the population. This may be attributed to a fall in real wages, increases in some prices such as those of fresh fruits and vegetables and certain services and to the absence of much evidence of a resumption in growth. This dissatisfaction is reflected in industrial action by work slowdowns and sporadic strikes especially in the public sector. A general strike on January 24 was much more successful than previous attempts during the Alfonsin regime.

3. The Government feels mounting pressure to take some actions in the immediate future to help arrest the rising tide of disillusionment. Some mid course corrections to the Plan Austral may be announced in the next few weeks. These will probably be geared towards reactivation of the economy with particular emphasis on the industrial sector. That sector has been particularly hard hit in the last year, and is also perceived to have the best potential for rapid export growth. In line with these new initiatives, there have been a number of changes in personnel. One of the principal ones has been the appointment of R. Lavagna to the cabinet as Secretary with the combined portfolios of Industry and Commerce.

4. The issue of the external debt is quite pervasive not only among government officials but among the public at large. Argentina's capital stock has deteriorated in recent years so that a resurgence of investment levels is essential. A restoration of historic saving levels to around 20%

of GDP, together with a continuation of its traditional surplus on external merchandise accounts, would normally augar well for development in most countries. However, an interest burden of 6% to 7% of GDP creates a dramatically different scene. As the economy struggles to restore its depleted capital stock, additional resources are needed at this critical juncture. Many feel the country is not reaping too many benefits from its current approach. It is facing strong resistence in external markets, particularly for agriculture. Russia is now taking close to 75% of wheat exports. The E.E.C. subsidy on beef is close to Argentine domestic production costs. The government has made a heroic effort to bring up-to-date payments on both its own debt and that contracted by the private sector and assumed by earlier governments. Many are hoping for some alternate approach to the debt problem rather than the current approach which many see as little more than a reordering of the cash flow.

Economic Situation

5. National Accounts: The GDP fell 4.6% in 1985. This brings a reduction in per capita income by 6.4%. Manufacturing is the hardest hit sector with its output falling 19%. Agriculture was affected by untimely rains. The wheat losses alone are estimated at 30%. Overall, agricultural production remained stagnant, with only a slight growth in the livestock sector. Both consumption and investment fell about 7%. On the other hand, exports rose 10% while imports declined 10% in 1984 prices. The trade balance for the first nine months was US$3.8 billion while that for the year is expected to be close to US$4.2 billion. Total gross investment level is 11% to 12% of GDP with about half of it provided by public sector. Signs of resurgence in private investment have yet to materialize. Following the recent situation of rear hyperinflation entrepreneurs are somewhat cautious. Many feel they are waiting to see the measures proposed for the second stage of the Plan Austral.

6. Prices: Under the Plan Austral, wages and prices for processed goods have been tightly controlled. More than half of the CPI increases may be attributed to two areas - fresh foods and services. In Buenos Aires much of the vegetables and fresh fruits come through small outlets and many of these retailers have sought to protect their real income by increasing their markups. The supermarkets, which provide about 40% of the food purchases in Buenos Aires, have been quite cooperative in holding the line on prices. The WPI has exhibited modest increases of .6%, 0.7%, 0.7%, 1.0% for each of the last four months of the year. However, the CPI continued to show low monthly increases of 2.0%, 1.9%, 2.4% in September, October, November, but then rose by 3.2% in December. The fall in real wages is estimated at 15% to 20% in the last six months. This was quite disturbing for the authorities and has led labor leaders to intensify their demands for wage increases. As in most price control schemes, anecdotes are rampant - some days chickens (price controlled) vanish from the markets only to reappear the following day in parts (not controlled); the computer of the central market seems to be suffering chronic malfunctions etc. The service component exhibits a rather different phenomenon. The official CPI is based on 1974 figures. At that time, a much larger share of the

population used medical doctors for health care. Many of these professionals have increased their fees by 50% to 100% since June. This, in turn, contributes a major increment to the calculated CPI growth. Doctors fees today do not play as important a role in health care costs so that the increase in this component of the index may be overstated. However, the time is not politically expedient to modify this seeming anomaly.

Other prices, wages, interest rates and exchange rates:

7. Wages are controlled in nominal terms for most wage and salaried workers with only a modest number of firms providing sub rosa increments. The unemployment rate is 5.1%. Some estimates suggest a modest increase in the demand for labor during the last 3 months. However with average levels of capacity utilization 10% below that of 1984 there is a lot of underemployment.

8. Starting with a virtually demonetized economy (before the introduction of the program in May M1 had fallen below 2% of GDP and M2 to 6.4% of GDP), the Central Bank set the monthly deposit rate at 4% per month and lending rate at 6% for the regulated segment of the market. Such high rates eliminated the possibility of an initial massive capital flight and diverted deposits from the so-called "interfirm" market to the banking system. These rates have gradually been lowered and reached, towards the end of the year, 3% and 4.5% for deposits and lending, respectively. By December 1985, real M1 had risen close to 100% above the May level.

9. Interest rates applied in the interfirm market, as well as those applied by the banks in their non-regulated operations have been well above regulated rates. Since a large part of the deposits in the financial system have been absorbed by the Central Bank, the private sector's borrowing needs have been met partly by the interfirm market. Although there are not many firms whose operating surpluses are high enough to cover the rates applied in the free market (they ranged between 5.5% and 6.3% per month, towards the end of 1985), distress borrowing has sustained the demand for credit.

10. Interest rates for 7 day deposits were 4.6%, 5.3% and 5.6% for the months October, November, December. These positive real deposit rates together with various reserve and pseudo reserve requirements used by the authorities to keep a tight rein on the money supply results in high real rates for borrowers. The "call money" rate in October was 5.4% but then rose to 9.2% and 9.9% in November and December. Medium-term financing, is virtually non-existent, which stymies investment.

11. The real exchange rate continues to show strong resilience. In the Plan Austral, the new currency was pegged to the US dollar. (0.8A = 1$US.) A sharp devaluation of 18% before the plan provided some cushion. However, with a continual inflation rate differential, it is evident that this rate cannot be maintained indefinitely, although the mark-up in the parallel market rate continues to stay in the 10%-15% range. This may be

partly explained by the fact that the fall of the US dollar has provided an automatic devaluation. This is especially true as the U.S. accounts for less then 20% of Argentine trade.

Public Finances

12. Public expenditures on a cash basis for 1985 are estimated to be equivalent to 30% of GDP, close to the ratio in 1984, but down from 32.3% in 1983. Wages in the public sector have been held constant. The deficit of the consolidated non-financial public sector in 1985 is estimated to be around 3% of GDP with perhaps an additional 1% for losses by the Central Bank.

13. On the revenue side, tariffs and receipts from public utilities are up, while improvements in the administration of VAT and income taxes have resulted in modest increases. It has been decided to increase the YPF share of its sales revenues to 60 percent.

14. Public investment continues to remain low (5% of GDP) in 1985, mostly reflecting the lack of counterpart funds. For 1986, it is estimated that minimal external financing should be related to a fiscal deficit of 3%. This appears to be a minimum figure to avoid creating tensions in the market and aggravating arrears while, at the same time, not perturbing expectations unduly.

15. Financing for the public sector would need approximately US$2 billion with most of this expected from the IMF, World Bank and IDB and the remainder from the commercial banks.

Relations with IMF/Creditors

16. Argentina is currently under a standby agreement with the IMF. This expires on March 31st 1986. For the 1985 year end targets there were some differences primarily with the public sector current account levels and the deficit of some public enterprises. This in turn means that revisions of 1986 targets have not yet been completed. Negotiations for the 1986 economic programs remain in a state of flux with public sector deficit, being central.

17. Disbursements by the external commercial banks are linked to the IMF program. They were to provide US$4.2 billion of "new money". US$3 billion has already been released. The remaining US$1.2 billion is expected to be released with the last two tranches of the Fund standby. The Government estimates 1986 maturities at US$9.3 billion. On the basis of an agreed economic program with the Fund, the banks expect to start negotiations shortly.

18. Changes/New Emphasis on Policy: The course of economic policy in the near future is quite uncertain, despite a general agreement both within and outside of Government that some expansion of the economy would be required in the near future. The budget for 1986 is expected to be

finalized in the coming weeks. Negotiations with the IMF appear to have reached a critical stage. Policy areas targetted for particular attention include:

- Industry and Trade. The government expects to put together an export promotion and investment plan involving 30 or more private companies. These companies would be typically in the high-tech areas with proven export potential in many instances but also identified as prospective leaders in an eventual recovery. These would include numerically controlled machine tools, bio-technology, agriculture equipment and possibly an export oriented fishing industry. It is expected to contribute an additional US$1.7 billion annually to the trade balance at the end of 3 years. Main bottlenecks are the lack of adequate financing at appropriate rates and an inadequate institutional backup. Details of the required incentives are currently being developed.

- Privatization. The government seems determined to move beyond the talking stage. Early candidates are SOMISA and petrochemicals.

- New Housing Policy. This will involve the Banco de la Provincia de Buenos Aires and be dependent on whatever liquidity constraints deemed essential by the Central Bank. It is expected to provide finances to private purchasers by issuing bonds.

- Oil Policy. The policies announced in Houston will be implemented. These now seem to be acceptable to the international community. The gas pipeline from Lomo de la Lata - Bahia Blanca - Buenos Aires will go ahead at an estimated cost of US$1 billion, externally financed.

- Communications. The auto-financing scheme of Megatel will be maintained to strengthen its success in its initial period.

Bank Involvement

19. The Government expects the Bank to help in a number of areas. The Government expressed appreciation of the assistance provided by the Bank recently. They made particular mention of the public sector investment review, including the analyses of the energy and transportation sectors. They indicated that many ideas in this latter report helped illuminate their policy deliberations.

20. The PPR funds related to the Technical Assistance Loan are now being used in a wide range of areas to help facilitate many pressing policy issues. It is expected that the loan itself will be finalized shortly to help maintain this momentum.

21. The agriculture loan is included in the financial plan. Revenues from the envisaged land tax are included in this year's budget. Although

the amount will not be significant this year, the GOA considers it important to establish the principle. While there is some confidence that measures will pass in the congress it is expected that senate passage will be much more difficult.

22. On the industrial promotion plan, the availability of financing is critical. The issue arose as to whether the Banade load might be of use here to provide financing in the near term.

23. With respect to the overall reactivation package, there are a number of issues which need some Bank consideration. Many industries seem to be facing a bottleneck as they are unable to provide adequate credit in the domestic market to potential customers. In a free trade milieu they would be unable to compete with external vendors who could provide financing. The government wondered whether the Bank could be of assistance here? This issue becomes increasingly important as the economy seeks a broad based recovery. Exports form a small portion of the overall demand while disbursements against imports may not be the most pressing need in some instances and indeed may aggravate the debt situation and place some domestic companies at a disadvantage.

24. Manpower/Training. As the economy is restructured, significant disequilibrium in the manpower/skills market is expected. The government is interested in any ideas we might have on how this transition might be eased. It seems that any schemes in this general area should involve the private sector at an early stage as they would eventually provide the jobs.

Economic Mission

25. An economic mission has been tentatively scheduled for March/April 1986. The mission would address the issues of reactivation of the economy. It would pay particular attention to macro-situation and the industry/trade sector. The mission would be based in the Ministry of Economy. An issues paper will be made available shortly. A Development Committee Brief (DCB) is scheduled by June.

PEOPLE MET BY THE MISSION INCLUDED:

Ramon da Bouza	Director of External Finance Ministry of Economy
Dario Braun	Assistant Director of External Finance, Ministry of Economy
Adolfo Canitrot	Secretary of Economic Coordination, Ministry of Economy
Luis Beccaria	Director of INDEC, Sec. Plan.
Simon L. Guerberoff	Director of Research and Economic Statistics, BCRA
Roberto Lavagna	Secretary of Industry and Trade
Dra Maria Beatriz Nofal	Subsecretary of Industrial Development
Roberto Frenkel	Advisor to Ministry of Economy
Hector L. Dieguez	IDES, Desarrollo Economica
Juan Sommer	Director of Domestic and External Debt, Ministry of Economy
Alberto Sojit	UNDP Technical Assistance Consultant
Alan Rausch	UNDP Technical Assistance Consultant
Adalberto Rodriquez-Giavarini	Subsecretary of Public Sector Programming and Coordination.

cc: Messrs. Knox, Gue, (LC2); van der Meer, (LCP); Pfeffermann, Jazpersen, (LCNVP); Carter, (LC2DR); Scherer, (o/r); Nankani (LC2DR); Balassa, (CON); Schultz, (LCPIDF2); Voljc, (IDF); Martinez, (LCFTR); Paz Estenssoro, (LCPTR); Israel, (PPD); Hanson, (INDFD); Dubey, (CPD); Kapur, (INDRE); Hope, (EPDED); Keare, (LCPED); Batzella, (EGY); Ms. Garcia De Truslow, (LCPUR)

Actions Needed

Subject	Actions	Time Frame
1. BANADE Loan	Decide on whether modification makes sense. Advise Government on action needed for modification.	1-2 weeks
2. Industrial Promotion Plan of Government	- Accelerate Bank dialogue - develop flexible approach - provide economic analysis in parallel	ASAP
3. Privatization	- Facilitate the ongoing process see back-to-office report of A. Kapur, INDRE of Jan. 1986	Mission scheduled for March
4. Manpower/Training	Advise government on possible approaches	
5. Provide support to government for MACRO policy analysis	- improve level of economic analysis in the division - transfer analytical capability to government	ongoing, particularly during economic mission
6. Market/Data Base	Provide timely information on markets and commodity price forecasts	ongoing

Annex 2
Table 1

Macro Indicators

	1983	1984	1985 1/
GDP			
(A bill. of Dec. 1985)	55.1	56.5	53.9
BOP ($US billion)			
Exports (FOB)	7.8	8.1	8.4
Imports (CIF)	4.5	4.6	4.1
C-A Def.	-2.5	-2.5	-1.3
Public Sector-Non-Financial			
% GDP (cash basis)			
Expenditures	32.1	30.7	28.9 2/
(wages and salaries)	(8.65)	(9.75)	(8.62)
(capital exp.)	(7.32)	(5.95)	(6.37)
Revenues	21.7	22.5	25.4 2/
Deficit	-10.4	-8.2	-3.5 2/

1/ Estimated.
2/ As contemplated in July 22, 1985 IMF Letter of Intent.

Selected Data
Prices (1985)

	May	June	July	August	Sept	Oct	Nov	Dec
CPI 1/	25.1	30.5	6.2	3.1	2.0	1.9	2.4	3.2
WPI 1/	31.2	42.3	-0.9	1.5	0.6	0.7	0.7	1.0
Exchange Rate per $US								
Official	.525	.737	.801	.801	.801	.801	.801	.801
Parallel	.621	.802	.946	.953	.941	.925	.903	.855
Interest Rates 2/ (Monthly)								
Regulated	32.0	18.0	5.0	5.0	5.0	-	-	-
Free	34.1	21.4	8.1	8.2	7.7	-	-	-
Wages Real 3/								
	84.6	79.4	74.8	72.6	71.1	69.8	68.2	66.1

1/ BCRA, percentage change during period, CPI (1974=100), WPI (1981=100).
2/ Commercial Banks, 30-day money lending rates.
3/ INDEC, Industrial Wages (Base 1983=100), average of office and blue-collar series.

→ Argentina RB.

January 16, 1986

Mr. Ernest Stern

Ernie,

Discussions with the Fund on Argentina are not concluded, in fact, they have not even begun. Finch says that he has had to consult with MD and while he would like to make an input to the paper, he cannot promise that this would be done before the end of January. Apparently, Mr. Beza cannot find time to focus on it. The paper has been with the Fund for three weeks.

Finch says that he has little problem with the substance of the paper and its thrust. He, however, recognizes that while we start with a growth premise, they want to start with the balance of payments and there may be some differences in nuances and analysis. I have told Finch that at all cost we want to avoid separate papers from the Bank and the Fund. I also told him that we cannot begin discussing things unless they put the issues on the table which they have not.

Finch also says that they are opposed to giving a paper to the Argentines. Their preference is to have the paper from which we can talk to the Argentines. I think we need something very concrete on the table for the Argentines to react to. I have told Finch that Clausen would raise these issues at his meeting with de Larosiere on January 21. Choksi was present at the meeting. If you wish further details, please call him. He is also liaising with the Fund, so please let him know the conclusions of the meeting between Clausen and de Larosiere.

Shahid

cc: Messrs. Dubey, Choksi

FORM NO. 75
(9—78)

THE WORLD BANK

ROUTING SLIP	DATE: 1/22/86

NAME	ROOM NO.
Mr. Choksi	N-623

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE	x	PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		URGENT

REMARKS:

FROM:	ROOM NO.:	EXTENSION:
N. Carter	E-923	72013

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

NC's chron

→ Argentina BR.

DATE January 16, 1986

TO Mr. S. Rajapatirana, VPERS

FROM Nicholas G. Carter, LC2DR

EXTENSION 72013

SUBJECT Argentina Baker Initiative Projections

1. Attached, as discussed, are the detailed printouts of the projections we used in writing our "Baker" paper for Argentina. As I pointed out, the model is a standard RMSM with the exception that real per capita consumption is specified as a target and thus GDP is determined endogenously, from the expenditure side, by the model.

2. The notion that the "export growth rate must be greater than the interest rate" in order to overcome a debt problem, is a perhaps useful, but certainly not universal rule of thumb. It also suffers from dimensional problems (debt is a stock, exports are a flow). The Argentine case is an instance where the "rule" does not hold. Consider the following very simple model of debt:

1. $dD = M - E + iD$

where M, E, and D are imports, exports and debt, and i is the interest rate. This yields:

2. $dD/D = M/D - E/D + i$

3. The problem is then to look for conditions such that $dD/D < 0$. In the Argentine case, there is a large resource surplus, equivalent in 1985 to 8.5% of the total stock of debt, leaving a shortfall of only 1.5% when compared to the roughly 10% interest rate. Given that the interest rate is projected to be approximately constant over the projection period, all that is necessary to overcome the debt problem is for the resource surplus to debt ratio to grow until it exceeds the interest rate, and this is in fact what happens in the Argentine projections. Note that in the short run it is not even necessary to require that exports grow faster than imports provided that they are sufficiently larger than imports. Once the resource surplus exceeds interest payments, debt can be paid off and the "problem" collapses very quickly. This is an interesting variation on the debt problem and one that not surprisingly, has not been explicitly dealt with before.

Attachments

cc: Messrs: Sokol LC2PB, Hwa EPD

NGC:pw

P 1866

ARGENTINA: BAKER INITIATIVE PAPER

A Proposed Agenda

STABILIZATION

1. For a long time there has been consensus that stabilization is a sine qua non for the country's future growth and development. In June 1985, the Argentine Government finally reacted to the threat of hyperinflation by implementing the "Plan Austral". In the following months, inflation dropped to around 2% per month and new agreements have been reached with the IMF and foreign bank creditors. However, given the experience with previous stabilization programs, it is too early to claim that the Austral Plan has been successful. Furthermore, in the next four to six months, the Argentine Government will have to face very difficult choices to consolidate stabilization. The Region may like to elaborate on the current state of the Austral Plan, on the possibility that the program might fail and on the alternative strategies that the Argentine Government will have to follow to consolidate stabilization. The Region could then discuss the implications of stabilization for structural policy reform, and consequently for the prospects of growth.

POLICY REFORMS FOR SUSTAINED GROWTH

2. The long-run stagnation of Argentina can be explained by a clear declining trend in the productivity of capital and labor (Only in recent years the accumulation of capital has been very low). But this declining trend can be explained by underlying distortions in the economy and inefficiencies in the operation of the public sector. However, these distortions and inefficiencies have in turn been the product of the political system over a long period of time. After the civilian Government assumed office in December 1983, there has been some changes in the political situation. The Region may wish to clarify if these changes have had a significant impact on the political system and, therefore, if the suggested institutional and policy reforms can be expected to follow realistically from it without being later reversed as had previously happened. The Region might then wish to elaborate on the best timing of the proposed reforms from the point of view of the political feasibility.

3. Leaving aside the political feasibility of the institutional and policy reforms, the pervasiveness of distorsions and inefficiencies imply a large number of reforms. These are very difficult to assess and to implement (even assuming the political will to effect them). The Region might care to elaborate on the merits and technical feasibility of an approach based on partial agreements on "packages" of specific reforms, vis a vis an approach based on a general, long-run agreement on specific objectives and mechanisms to monitor progress towards their achievement.

PROJECTIONS

4. The paper provides two scenarios for the period 1986-90, one of which is based on the continuation of current policies. Regarding this scenario, could the Region clarify the meaning of these policies as well as their economic and political feasibility?

5. The other scenario, the high-growth one, is based on the policy reforms discussed in the paper. Could the Region elaborate on the likely impact of these reforms and on the timing of the effects?

6. In both scenarios the evolution of two external variables -- interest rates and the terms of trade -- has a significant effect on the growth of output and on the balance of payments. Could the Region elaborate on the effects of different values of these variables on output growth and external financing requirements? In particular, could the Region clarify the implications of the recent decline in the terms of trade?

DRAFT
11/26/85

ARGENTINA

1. Argentina has the potential to reverse the current recessionary trends in economic activity and gradually achieve respectable growth rates while reducing its debt service burden. Fulfillment of this potential is predicated on the adoption of radical and comprehensive policy reforms.

2. The Government has recently initiated a bold program to stabilize prices, reduce the fiscal deficit and strengthen the external accounts. The results have been spectacular: monthly inflation has fallen from about 30% in May to 1.9% in October; the overall budget deficit has been cut down from 12% of GDP in 1984 to about 2% of GDP in the second semester of 1985; the deficit of the current account of the balance of payments was reduced from 3.5% of GDP in 1984 to about 2% of GDP in 1985. However, the stabilization program has encountered difficulties. First, while the Government has performed very well in raising revenues, it has been less successful in containing the spending of some public enterprises and provincial governments. The fiscal deficit is therefore likely to exceed the targets set by the Fund. Second, while nominal rates of interest have fallen dramatically, real financing costs remain as high as 3% per month. As a consequence, bad loans and credit risk are on the rise. Third, the deficit of current account of the balance of payment is expected to widen again in 1986, primarily because of recent floods which have hampered agricultural production and of a continued deterioration of the terms of trade.

3. The first hurdle that needs to be overcome is the transition from wage and price freeze and a tight credit policy to a regime that would provide flexibility and adequate liquidity for growth. To proceed on this course without once again destabilizing the economy, the Government needs to undertake measures which should permanently reduce the fiscal deficit as it implements a concerted and gradual phasing out of wage and price controls.

4. The Government has stated its intention to address the root causes of Argentina's economic woes through comprehensive structural reforms. At the moment it is just probing its way. It is considering to eliminate most quantitative restrictions on imports and replace them in a first stage, by equivalent tariffs. The Government is also moving to reduce state participation in some sectors to reduce pressure on the fiscal deficit. It has also normally indicated interest in Bank support for the privatization of its petrochemical holdings in the Fabricaciones Militares complex. However, the Government's actions have not been swift and well organized. For example, in petroleum exploration and exploitation it has not defined a clear note for the private sector; in telecommunications, it has decided to entrust the expansion of Argentine's seriously defective telephone network to a public sector company that has been unable to operate the existing systems satisfactorily. More generally, influential

groups in the Ministry of Public Works, the labor unions, the Peronist Party, and even some groups within the Radical Party lobby against reforms that the Ministry of Economy promotes.

5. The Government needs to act on several fronts simultaneously: improve the incentive system, streamline public expenditure, restructure the financial sector, and strenghten the defficient infrastructure. The attached matrix details the policies and measures and their sequencing, that are, in our view, required to achieve the objectives mentioned above. The following paragraphs summarize our judgment on their relative importance.

6. The Government should give first priority to eliminating export taxes and quantitative import restrictions. A comprehensive trade policy reform including uniform low rates of effective protection, only seems feasible once the economic recovery is well under way. The disastrous results of the attempts during 1977-81 to open up the economy are still fresh in the memory of all Argentines. Meanwhile, the gradual process of rationalizing the trade regime should support a concerted major drive to promote industrial exports. We have estimated that such a program (Annex II), which could be supported by Agricultural Sector, Trade Policy and Export Promotion Loans (Annex I), would generate incremental foreign exchange earnings of about US$1.2 billion from agricultural exports and of US$1 billion from industrial exports.

7. While putting the private sector under increasing competititve pressure, the Government has to put reorganize its own house. The thrust of this effort should be to improve the efficiency of public sector enterprises with a view to assuring their operation as commercial enterprises, including adequate price and cost recovery polices. This should be based on a clear definition of the public sector's future role in the Argentine economy, and should also include the divestiture of public enterprises as required. Among the measures that should be taken are: reduction in public sector employment through attrition and restructuring of major public enterprises (especially YPF, ENTEL, Railways, SOMISA). Hoever, restructuring, and possibly privatizing public enterprises will be a lengthy and difficult endeavor. The program of action in proposed Annex II would contribute significantly to strengthening public sector finances, improve the efficiency of investment and enhance the competitiveness of industry. Preliminary analytical work to improve the efficiency of public enterprises has been initiated. The Bank could support such a reform program through sector loans in transport, energy and restructuring loans for SOMISA and ENTEL (Annex IV).

8. The definition of the public sector's contribution to the growth of the economy should also indicate the priorities of the public investment program. Our recent review of the investment program has shown that these priorities are (i) improvement of port services, (ii) reconstruction/ maintenance/graveling of high traffic roads; building of feeder roads for main export corridors; (iii) enhanced oil recovery/liquid extraction and gas gathering projects, acceleration of oil and gas pipeline construction; (iv) reinforcement of power transmission/distribution lines. Furthermore, a central project processing/monitoring unit should be established to implement the criteria and investment priorities that are agreed upon. As

regards the financing of public projects, improvements in tax administration and public tariff structure should be undertaken simultaneously with the elimination of earmarked funds which often lead to an inefficient allocation of resources.

9. Argentina has the potential to export around 70,000 - 100,000 barrels per day of crude oil or petroleum products, amounting to US$0.7 - 1.0 billion, by increasing the recovery rate of petroleum extraction and substituting oil for gas. Annual investments of US$1 billion or more would be required in the petroleum sector and around US$500 million annually for gas transmission and distribution over the next five years. Under the foreseeable constraints on government investment funds, neither YPF nor GdE will be able to finance such programs on their own, now would they have the capacity to implement them. However, by involving the private sector and by using new financing instruments such as project financing and funds from international development banks, implementation of such inestment programs could be feasible even in the present environment of tight public investment funds.

10. Because of the risks involved, the needed reform of the financial system has to proceed in stages. There may ultimately be no alternative but to let a few private banks fail. It is equally important, if not more so, for the Government to bear down hard on the public banks which require excessive operating spreads and are saddled with bad portfolios; a comprehensive drive to increase efficiency in the banking system through mergers and bankruptcies should be initiated soon. The Government will have to proceed gradually and with caution, however, in order to avoid a financial crisis. The Bank could assist the adjustment process through a financial sector loan (Annex I).

11. If the above reforms are undertaken, most economic indicators, such as the debt service ratio, would not show a significant change by 1990. However, real GDP growth is projected to reach a 5-6% range and exports would be expanding on a faster and sustainable track with buoyant export performances by agriculture, industry and hydrocarbons. Moreover, the debt service ratio and growth performance would show significant improvements during the coming decade. If many of these reforms are not undertaken expediently on the other hand, one can expect growth rates to hover around 3% per annum, but even this may be overly optimistic given the current debt burden.

ANNEX I

COUNTRY: ARGENTINA
FY86-FY90 PROPOSED LENDING PROGRAM - PROJECT DETAIL
NOVEMBER 27, 1985

MANAGING UNIT	PROJECT / STATUS		PLAN/ACT. APPRAISAL DEPARTURE	US$ Million BANK
FY86				
LC2PB	PA041-TAI-B	L	11/85	20.0
LCPWS	PA025-Water Supply-B	L	02/85	60.0
LCPAC	PA036-Agric. Sector-C	L	05/85	350.0
LCPEN	PA042-Power Eng.-B	M	11/85	10.0
	FY86 Totals: Lending Amount			440.0
	Number of Projects			3
FY87				
LCPT1	PA024-Bahia Blanca I-C	S	12/84	40.0
LC2PB	PA050-Trade Policy-C	L	06/86	350.0
INDD2	PA047-Refinery Supp Ln-S	M	11/85	110.0
LCPI2	PA046-Sm. & Me. Ind. B	L	06/86	100.0
EGYD2	PA038-Oil & Gas Sector D	L	06/86	200.0
	FY87 Totals: Lending			800.0
	Number of Projects			4
FY88				
LCPI2	PAO -Financil Sector D	S	06/86	350.0
LCPEN	PA051-Power Distrib. D	L	09/86	150.0
LCPI2	PA046-Export Promotion C	S	06/86	200.0
LCPEN	PAO -Yacyreta-C	S	06/86	200.0
LCPAC	PAO -Agric. Sector II D	L	09/86	350.0
	FY88 Totals: Lending Amount			1,250.0
	Number of Projects			5
FY89				
LCPI2	PA027-Industrial Cr. II-D	S	06/87	150.0
LCPI2	PAO -Financial Restruc.D	L	06/87	100.0
LCPI2	PAO -Financial Sector D	L	06/87	350.0
EGYD2	PA028-Oil & Gas Private D	S	06/86	100.0
LCPI2	PAO -Trade Policy II D	L	06/87	350.0
LCPEN	PAO -Transport Sector I	D	06/86	350.0
	FY89 Totals: Lending Amount			1,400.0
	Number of Projects			6
FY90				
INDD3	PAO -SOMISA Restruct. -D	L	06/87	50.0
LCPEN	PA051-SEGBA V C	L	06/88	150.0
INDD4	PA055-ENTEL Restruct. -D	L		150.0
LCPWS	PAO Water Supply D	L	06/89	80.0
LCPI2	PA053-Export Promot. II-D	L		100.0
LCPURB	PAO Housing D	L	06/89	75.0
LCPURB	PAO Market Town Impr.-D	L	05/89	75.0
LCPTR	PAO Transp. Sector II-D	L	06/89	350.0
	FY90 Totals: Lending Amount			1,030.0
	Number of Projects			8
	TOTAL LENDING AMOUNT			4,920.0
	NUMBER OF PROJECTS			26

November 26, 1985

ARGENTINA - PROPOSED MEDIUM-TERM ADJUSTMENT AND GROWTH PROGRAM

High-Growth Option

Main Goals:
(1) To restore and sustain real economic growth of 4% on average during 1986-90.
(2) To expand exports in real terms by 6% on average during 1986-90.
(3) To maintain a sound balance of payments position, consistent with a reduction in the debt service ratio from 85% in 1985 to 63% in 1990.
(4) To reduce domestic inflation to about 20% per year on average during 1986-90.

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing				
				1986	87	88	89	90
A. TRADE (including agriculture and industry)								
1. Exchange Rate Policy	Maintain international competitiveness	Crawling peg devaluations during first half of 1985; 18% one step devaluation in June 1985	Maintenance of competitive exchange rate policy through periodic adjustments which are at least equal to the difference between domestic and international inflation;	*	*	*	*	*
	Improving the effective exchange rate in agriculture	Export tax on wheat reduced from 26.5% to 15% (September 1985)	phased reduction of export taxes on agricultural commodities:					
			(i) temporary increases imposed in June 1986;	*				
			(ii) reduction of rates to no more than 70% of the rates in force in May 1, 1985;		*			
			(iii) reduction of rates to no more than 50% of the rate in force on May 1, 1985			*		
						*		
	Improving the effective exchange rate in industry	Export taxes on industrial exports eliminated (August 1985)						
2. Import/Export Policy	Elimination of prohibitions and quantitative restrictions		Phased elimination of most import licensing requirements:					
			(i) Reclassification of 4,000 (100%) tariff positions from prohibited to free with introduction of additional (equivalent) tariff protection	*	*			
			(ii) reclassification of 1,300 (100%) tariff positions from prior consultation to free with introduction of additional (equivalent) tariff protection	*	*			
			(iii) redesignation of tractors and agricultural machinery from the prohibited to prior approval list.	*				

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing				
				1986	87	88	89	90
A. TRADE (including agriculture and industry)								
1. Exchange Rate Policy	Maintain international competitiveness	Crawling peg devaluations during first half of 1985; 18% one step devaluation in June 1985	Maintenance of competitive exchange rate policy through periodic adjustments which are at least equal to the difference between domestic and international inflation;	*	*	*	*	*
	Improving the effective exchange rate in agriculture	Export tax on wheat reduced from 26.5% to 15% (September 1985)	phased reduction of export taxes on agricultural commodities:					
			(i) temporary increases imposed in June 1986;	*				
			(ii) reduction of rates to no more than 70% of the rates in force in May 1, 1985;		*			
			(iii) reduction of rates to no more than 50% of the rate in force on May 1, 1985			* *		
	Improving the effective exchange rate in industry	Export taxes on industrial exports eliminated (August 1985)						
2. Import/Export Policy	Elimination of prohibitions and quantitative restrictions		Phased elimination of most import licensing requirements:					
			(i) Reclassification of 4,000 (100%) tariff positions from prohibited to free with introduction of additional (equivalent) tariff protection	*	*			
			(ii) reclassification of 1,300 (100%) tariff positions from prior consultation to free with introduction of additional (equivalent) tariff protection	*	*			
			(iii) redesignation of tractors and agricultural machinery from the prohibited to prior approval list.	*				

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
	Achievement of neutral status for export industries		Reform of the temporary admission regime for imported inputs:					
			(i) simplification of administrative procedures	*				
			(ii) guarantee of automatic access to any products	*				
			(iii) coverage of indirect exporters	*				
			(iv) extension to capital goods used for export production	*				
			(v) extension of the tax reimbursement scheme to exports processed under the temporary admissions scheme	*				
	Reduction of import tariffs		Removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985	*				
			Preparation of studies needed to support the adjustment process:					
			(i) to rationalize the import tariff structure	*	*			
			(ii) to rationalize the structure of tax rebates for exports	*	*			
			Implementation of recomendations of above studies			*	*	*
	Improving the administrative mechanisms of trade management		Simplification of export producers, eliminating all unnecessary interventions by public sector agencies	*	*			
3. Export Financing	Rationalize and extend financing for exports		Remove the exclusive linkage of pre-shipment financing with dollar-indexed or dollar deposits	*				
			Facilitate joint financing by banks	*				
			Review the level of financing subsidies with a view to reduce them	*	*			

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing				
				1986	87	88	89	90
			Allow export plans by exporting firms as a basis for banks to determine the amount of Central Bank credit lines for pre- and post-shipment financing	*	*			
			Broadening risk coverage of exporting firms	*	*			
4. Information System	Adequate and timely availability of foreign trade and export market information		Develop a common, integrated data base	*	*	*		
B. FINANCIAL SYSTEM								
1. Interest Rates	Reduce in real terms		Lowering reserve requirements on sight and timed deposits		*	*	*	
			Reduce spreads between deposit and lending rate to no more than 4%		*	*	*	
			Elimination of credit subsidies		*	*	*	
2. Sector Restructuring	Create a more healthy financial sector		Removal of mechanisms to increasing the minimum capitalization required for a financial institution		*	*	*	
			Temporary fiscal measures to encourage consolidation		*	*	*	
			Reduction of number of banks and employees		*	*	*	
3. Tax System	Significantly phase out export taxes in agriculture and replace by production neutral taxes		Introduce a federal based land tax		*			
	Improve tax administration		Improve information flow by unification of tax payer identification for each separate tax collecting entity	*	*	*		
			Phase out expensive visit system in favor of distribution of information on cross--compliance	*	*	*	*	
			Penalties for evasion to be sharply increased	*	*			
			Concentrate audit efforts on VAT	*	*	*	*	*

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Ensure that penalty interest remains significantly above taxpayers cost of capital	*	*	*	*	*
			Eliminate amnesties	*	*			
	Increase the yield from the existing structure and shift the burden to income, value added and wealth taxes		Income taxes (corporate): to be left largely as is except to:					
			(i) broaden the base;		*	*		
			(ii) include profits on the sale of rural properties		*	*		
			Wealth taxes:					
			(i) to be extended (due to run out in 1985) as is;	*				
			(ii) to eliminate deduction of 50% of assessed value of agricultural property.		*			
			Taxation on goods and services					
			(i) turnover tax to remain unchanged;	*				
			(ii) in VAT eliminate most of exemptions given for industrial incentives purposes.		*	*		
			Excise tax: (i) not to be broad		*	*		
			ened; (ii) focus on commodities where Government has direct con trol over the collection (e.g. gasoline)	*				
C. PUBLIC SECTOR								
1. Public Sector Investment	Improving efficiency of operations		Productivity increases:					
			(i) reduction of public employees through attrition (as much as 10% per year)	*	*	*	*	*
			(ii) adequate wage differentiation and production incentives			*	*	*
			(iii) reinforcement of managerial accountability and introduction of cost accounting in public enterprises	*	*	*	*	*
			(iv) cutting uneconomic production and transport loses; and	*	*	*	*	*
			(v) restructuring of some enterprises to expose them to competition				*	*

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Revenue Sharing:					
			(i) elimination of earmarked funds for non-priority projects		*			
			(ii) allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources; and		*	*	*	
			(iii) real increases in water and electricity tariff revenues	*	*	*	*	*
			Actions on non-priority investments:					
			(i) in energy: minimization of coal investments and postponement of major hydroelectricity projects	*	*			
			(ii) in railways: elimination of electrification schemes and reduction of investment in passenger traffic	*	*			
			(iii) in maritime transport: slowing down the expansion of the merchant fleet; and	*	*	*		
			(iv) in industry: cancellation of the expansion of the petrochemical production capacity in Bahia Blanca, of the new sheet steel rolling mill by SOMISA, and of the shipyards expansion	*				
2. Energy Sector	Infrastructure development		Government decision on the expansion of the gas transportation system through significant private participation	*				
			Solution of the COGASCO dispute	*				
	Enhance the private sectors role		Award new exploitation contracts for oil and gas to private firms	*	*	*	*	*
			Award new exploration contracts to expand out and gas reserves	*	*	*	*	*
			Increase private sector participation by reducing YPF	*	*	*	*	*

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			Limit or eliminate convertibility risks (i.e. exports of products as guarantee for foreign currency obligation)	*				
			Facilitate access to domestic credit (i.e. apex financing arrangements support private sector borrowing needs)	*	*			
	Improving the operations of public enterprises		Financial strengthening and streamlining of YPF and GdE (including reviews of their organizational structure, accounting and control systems	*	*	*		
	Improve pricing and taxation		Adjust the price of natural gas as a function of its long run opportunity cost	*	*			
			Adjust the price of diesel as a fuction of the regular gasoline energy equivalent	*	*			
			Review the level and structure of prices of other energy products		*			
			Review the costs and benefits of the existing structure of taxation of the sector with a view to increasing efficiency		*			
	Increase conservation		Design and implement an energy conservation program including price and taxation aspects			*	*	
			Study the energy efficiency of the power sector and of the possibilities for end-used conversion and savings		*	*		
3. Transport Sector	Allow public enterprises to operate like commercial entities		Increased prices of public services to assure adequate cost recovering in such areas as road user costs, port tariffs, dredging costs, and railroad and airline tariffs		*	*	*	*

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
	Improvement of efficiency of operation of railways		Reduction of manpower (currently 108,000)	*	*	*	*	*
			Closure of uneconomic lines		*	*	*	
			Generation of operation/line specific economic information to allow assessment of expenditure programs	*	*			
			Overall reduction of 1986-90 investment expenditures by 60%	*	*	*		
			Shift in investment priorities:	*	*	*		
			(i) from passenger traffic to bulk freight	*	*	*		
			(ii) from the expansion of rolling stock to track renewal and bridge culvert construction					
			(iii) from administrative investment to control of operations, including the coordination of broad gauge lines	*	*	*		
	Improvement of efficiency of operation of maritime and air transport		Reduction in total investment expenditure		*	*		
			Introduction of a new system to cover major reequipment cost		*			
			Efficiency improvements in port dredging operations		*	*	*	
			Elimination of legal obligations to buy from domestic shipyards		*			
			Shifts in investment priorities: (i) from the expansion of the merchant fleet to dredging and		*	*		
			(ii) from airfleet standandization investment to extension of landing stops and the improvement of air traffic control systems		*	*		
	Strengthening of road transport planning		Shifting of priorities in road transport: (i) from upgrading/capacity increases to reconstruction					

Area	Policy Objectives	Actions Taken by Government	Further Measures Recommended	Proposed Timing 1986	87	88	89	90
			(ii) from projects with low rates of return (52% of expenditure) to higher traffic corridors		*	*	*	
			(iii) from new paving projects with low traffic to gravel surface projects		*	*	*	
	Initiation of institutional reforms		Consolidation of port agencies and urban rail authority			*	*	
			Studies to implement action programs			*	*	
4. Restructuring	Restructuring to improve efficiency and competitiveness of basic industries		SOMISA: cut costs, balance production lines and strengthen management/administrative practices				*	*
			ENTEL: improve operation and managerial efficiency				*	*
			Petrochemicals:					
5. Privatization	Programs for privatization of public enterprises		(i) identify potential investors		*	*		
			(ii) negotiate the sales price value of assets				*	*
			(iii) define the vehicle of transfer of assets to private investors				*	*

Argentina Paper

I. ECONOMIC PERFORMANCE IN RECENT YEARS

1. Argentina in most of this century has suffered more than most countries from a poor political milieu and inappropriate economic management. This has continued into recent decades. In Table 1.1 data suggest the roller-coaster nature of selected economic aggregates.

Table 1.1: Historic Data

	1978	1979	1980	1981	1982	1983	1984	1985*
Real GDP Growth Rate Per Annum	-3.4	6.7	0.7	-6.2	-5.2	3.1	2.0	-1.0
Debt to Export Ratio 1/	1.62	1.98	2.52	3.09	4.58	4.84	4.91	5.0
Interest Payments to Export Ratio (%) 2/	18.38	22.92	24.18	17.17	25.55	45.35	39.71	
Total Debt to GNP 3/	0.19	0.18	0.18	0.30	0.67	0.71	0.69	0.70
Interest Payment to GNP (%) 4/	2.18	2.06	1.73	1.70	3.76	6.36	5.59	
Debt Service Ratio (%) 5/	45.54	52.57	48.27	34.62	39.41	58.06	47.17	
Terms of Trade	78.3	82.9	93.8	106.7	92./4	88.3	93.0	89.3
Growth Rates of Imports	-4.9	45.4	45.4	0.4	-41.2	-2.4	1.5	-10.0
and Exports	12.2	-3.0	-4.9	5.9	-2.4	11.5	-1.2	4.6
Current Account Balance (US$ Millions)	1833	-537	-4767	-4714	-2357	-2461	-2492	-1700

Capital Flight (cumulative in US$ million) 25,000 (estimate for 1985)

1/ Total debt including short-term/exports goods and NFS
2/ Interest payments in MLT/EGNFS
3/ Total debt including short-term/GNP
4/ Interest payments on M&LT/GNP
5/ Debt service on M&LT debt/exports goods and NFS
* Estimate

II. THE ECONOMIC STABILIZATION PROGRAM

A. The Austral Plan

The Alfonsin government took office in 1983. They first used a gradualist approach with little success. As economic activity seemed to be perilously close to complete chaos, the Goverment changed gears and moved to shock treatment in mid-June 1985. President Alfonsin has staked his reputation on the success of the Austral Plan to break inflationary expectations. The main features were:

- Temporary wage-price controls. A number of critical prices were adjusted in advance. These included various public sector prices and a sharp devaluation to ensure a large surplus in the trade balance.

- The budget deficit was reduced significantly by increased tax revenues and lower Government expenditures. Much of the real increase in tax revenues came from the sharp fall in inflation (see Attachment 2).

- A monetary reform to defuse the possibility of large transfers from debtors to creditors on outstanding contracts. This would result as real interest rates would surge on the outstanding contracts after a fall in the inflation rates. A new currency, the Austral, was introduced pegged to the US dollar (0.8 Austral = US$1). This is expected to break inflationary expectations. The results of the plan to date are given in Attachment 2.

Projections

Two projections for 1985-90 are presented. The base case represents the best estimate of economic aggregates under the current policy milieu. A high case alternative is then discussed. The base case is what might be expected if current policies continue and external financing is available at moderate levels (estimated values are given in Attachment 4). The assumption for both scenarios are given in Attachment 3. In particular, it is assumed that all interest payments are made on schedule and amortization rolled over (except short term). The growth rates in the base case are close to the average annual rates Argentina achieved in the previous 20 years--about 3 percent.

The principal assumption for both scenarios is, that the stable political situation should be reinforced so that the policy initiatives of June can be maintained.

The main difference is that for the high case extra capital flow (shown as SHRTERM) permits a higher current balance. This in turn results from higher import levels. These together with improved policies help put the economy on a faster growth track. The conceptual framework may be outlined as follows. Prospects for sustained higher growth levels together with improved financial resources available to cope with external debt burden require a stronger export performance. Some improvement may be expected from wheat exports, particularly in non-OECD markets but the major improvement will eventually have to come from manufactured exports and hydrocarbons in the medium term. These in turn will require easier access to imports for industry to be upgraded. This high case seeks to model the stylized facts by introducing a strong boost for imports in 1986 and then falling to historic import elasticity levels by 1988 and onwards. This new money for higher import levels may be also interpreted as providing funds to offset some of the factor service burden and through this avenue releasing additional resources for investment.

Table 1.2: Results Base/High Cost

	Base		High	
	1986	1990	1986	1990
GDPMP--Growth Rate	2.5	3.3	2.4	6.0
GNP Per Capita (US$ 1983)	$2215	$2409	$2209	$2610
Government Revenue (% GDP)	24.3	24.1	24.4	23.4
Government Investment (% GDP)	6.5	7.4	6.6	7.5
Government Deficit (% GDP) 1/	-2.4	-2.0	-2.4	-2.0
US$ Current Billions				
Exports	9.2	14.1	9.2	15.4
Current Balance	-1.5	-0.5	-2.2	-0.9
Debt Outstanding and Disbursed	51.1	53.6	51.2	55.2
Short term (net) 2/	.1	.5	.8	.9
DS/XGS percent (all percent)	85	65	85	63
Additional Financing Needs Above the Base Case US$ Current Millions				
Gross			653	1020
Net			653	363

1/ Overall deficit of the non-financial public sector.
2/ Terms assumed 9/3 at 12.3 percent interest.

The results are summarized in Table 1.2 further policy details are given in Attachment 5.

For the high case larger import levels would be associated with lower GDPMP growth in 1986 than in the base case, but by 1990 would move to higher level over 6 percent annual. This in turn should help realize some of the heretofore unfulfilled expectations. The public sector deficit would still be held to current level.

The current account balance would show some deterioration in 1986 compared with the base case, but by 1990 would have recovered to the anticipated level of the base case. Debt service requirements would increase but the DS/XGS ratio would vary little because of higher export levels. The high case would require additional financing of about US$653 million net in 1986, changing to US$363 million net (US$1020 million gross) in 1990. This additional flow would then be reduced rapidly if exports (net of imports) continued to show the improvement anticipated.

Economic Mismanagement and External Shock

A. Economic Mismanagement

Successive mistakes and inconsistencies in the conduct of economic policies have weakened Argentina's productive capacity and exacerbated structural imbalances. In particular, the country moved too rapidly from high protection and government intervention to liberalization and deregulation without an adequate exchange rate policy and then moved back to more interventionist policies. Over the last decade, the country's external debt as a share of GDP has multiplied sevenfold (from 10% to 70%). Today, interest payments on the external debt absorb nearly half of gross domestic savings compared to less than 5% in the early 1970s. Instead of being used to strengthen export capacity, foreign borrowings were largely dissipated on consumption and military purposes, or simply financed capital flight. Argentina's private sector holdings in foreign banks are estimated to amount to nearly one-third of the public and publicly guaranteed debt outstanding. While external debt has grown, domestic production has declined. In 1984, real GDP per capita was 13% below its 1974 level. Investment has fallen to 11% of GDP, from an average of 21% during the early seventies. Annual net additions to the stock of buildings and physical infrastructure are only one-third of their levels in the early 1970s and the value of investment in equipment has been below the cost of depreciation since 1981.

With the exception of agriculture, which has been increasing its output and productivity, the productive sectors are beset by increasingly thorny structural and financial problems resulting from distortions, lack of incentives and excessive government intervention. More than 40% of capacity in the construction industry, rapidly expanded during the construction boom of the late seventies, now stands idle. At the same time, a large unfulfilled demand for housing for the middle and low-income groups exists. Capital equipment is also idle in many manufacturing industries and is becoming increasingly obsolete. Most firms are short of working capital. Firms that did relatively well in the recent past were typically not those with a genuine comparative advantage; rather, they were the ones with the close links to the public sector, often with high levels of protection against foreign competition, and the easiest access to foreign (initially cheap) credit. "Good management" became synonymous with skill modernization and reorganization of the real economy took a back seat. Intermittent gains in competitiveness (labor productivity increased by 25% between 1974 and 1982) were lost to an increasingly overvalued exchange rate and adverse changes in the incentives system. Proven reserves of gas have increased, but the processing and transport infrastructure to exploit them is deficient.

B. External Shocks

These domestic problems were aggravated further by an adverse external economic climate. During the period 1979-82 Argentina suffered external shocks equivalent to 4 percent of GNP. These were due primarily to deterioration in terms of trade and a rapid increase in interest rates. The policy response was primarily to resort to additional net external financing. This was accompanied by some contraction of economic activity. This effort was more than offset by deterioration in export promotion and a rapid increase in imports ("import promotion"). These external shocks and the poor policy response were further compounded by the Malvinas war and the concomitant political instability which eventually left the economy in tatters.

Table 1.2: External Shocks

External Shock % of GNP	Policy Response As a percentage of GNP				
Average 1979-82	Add Net External Financing	Export Promotion	Import Substi-tution	Macro Policy Effects	TOTAL
4.0	6.5	-1.5	-2	1	4

The Alfonsin democratic government took office in 1983. They faced a difficult political situation following the recent military adventures together with an economy in disarray. Inflation was running at close to 20 percent per month, the fiscal deficit was about 16 percent of GDP, while the external debt was in excess of US$45 billion. Debt was 70 percent of GDP, total interest payments were 9 percent of GDP (including short-term). Most social groups greeted the democratic government with strong expectations for improvement in their living standard after a period of economic stagnation. The Government first sought to address the situation with a gradualist approach. There was a modest gain in real output. However, in order to finance a seemingly chronic public sector deficit, the Government was obliged to resort to domestic sources. This in turn produced a steady increase in inflation.

Results to Date/Transition to Growth

The program has now been in operation over four months and the results to date have been quite spectacular. Some indicators are given in Table 2.1.

Table 2.1: Selected Macroeconomic Indicators

	1982	1983	1984	1985								
				I	II	III	M	J	J	A	S	O
Real GDP	89	92	93	95								
Industrial Prod.	80	88	91	85	83	89	85	79	77	81	84	
Real Wage (period aveg.)	80	100	120	136	131	112	138	123	115	112	109	
Open Urban Unemployment (percent)	4.7	4.0	3.8									
Parallel $ Premium Percent above Offical Rate	61	41	31	27	19	19	18	8	18	19	19	15.5
Budget Deficit		12	11	11	12.5	2.0*						
Inflation	187	380	659				25	31	6	3	2	1.9
Real Interest Rate	0.2	3.1	1.1	1.7	-5.4	5.7	2.6	-14.8	5.8	5.2	6.0	4.2
Real Effective Exchange Rate (1980-82=100)	75.9	71.2	79.9				76.7	75.6	68.1	67.1	67.8	

*Target

Notes: Real GDP, Index 1980=100; Ind. Production, 1980=100; Real Wage, Index 1983=100; Real Monetary Base, Index 1983=100; Parallel Dollar Premium, percent of Official Rate; Budget Defit, including Central Bank, percent of GDP; Inflation Rate of the CPI, annual rate except for 1985 where monthly rate is given; Real Interest Rate, percent per month, using WPI as deflator.

See Dornbusch/Morgan Guarantee

Perhaps even more important is the political impact of the plan. Opinion polls suggest overwhelming support. In the elections of November 3, President Alfonsin's party made strong gains in some provinces. However, the share of the overall vote fell to 44 percent from 48 percent, suggesting that economic progress is required if the current political support is to be sustained. In essence, this means that growth and real wages must soon achieve forward momentum while ensuring that achievements on the inflation front are consolidated. The official unemployment figures tend to be low in Argentina because of the particular institutional arrangements in that country so that the pecipitous fall in the real wage is a better indicator of the burden of the adjustment program on some groups.

C. The Transition to Growth

Given the recent (and not so recent) history of Argentina one cannot overemphasize the political dimension in designing a viable economic policy package. It is essential that the current fragile political consensus be strengthened quickly. In economic terms this includes the need to resume growth without the destabilizing effect of inflation. This in turn requires a two-track approach combining a judicious modification in fiscal, monetary and price (including exchange rate) policy with the initiation of a structural reform program. The stabilization policies should be pursued in a pragmatic manner such as has been shown in the application of wage-price controls since June. Thus as monetary policy is moved to an expansionary mode, to provide adequate liquidity for growth, inflationary signals must be acted on promptly and policies modified rapidly.

Is liq. a problem?

Fiscal Policy. In the short term much of the offset in revenues will be taken up by the Agriculture Loan (World Bank). This will provide room to introduce broad based taxes such as a wealth/land based tax. At the same time, administrative reform of other revenue sources, such as value-added tax, income and social security must proceed.

Monetary Policy. During the high inflation period preceding the June 1985 initiative the monetary base shrunk to 1 percent of GDP, thus removing the possibility of a viable source of financing. Since the June plan this real money supply has about doubled. However, to avoid any deterioration in inflationary expectations this growth must be kept under tight control. The real annual interest rate is still (October) around 40 percent. This in turn is a major deterrent to productive investment.

not so in table. Shows 4.2

The dilemma is that the Government must avoid any deficit financing by resorting to the printing press. However, if credit is too tight real interest rates will remain high. Most government financing will have to be done by monetizing capital inflows. As the program gains increasing credibility some of the other factors keeping real interest rates high may recede. These include: general confidence in the system which though improving is still not high enough to trigger major investment expenditures by the private sector: current banking operating costs are estimated at 2 percent per month; the anticipated financial sector reform should reduce this component of real costs to 0.5 percent. There are also some "disguised" reserve requirements used by the Central Bank to control credit which also pushes up the cost of money to the banks. If real interest rates do not fall soon (and realistically one cannot count on it) then some vehicle must be provided to channel investment funds to the private sector at lower rates.

Prices/Exchange Rate/Wages. Present wage-price controls are not accompanied by a major institutional/bureaucratic network and this should facilitate their removal. However, there is still the difficulty of avoiding a resurgence of the wage/price spiral. The sharp devaluation (18 percent) which preceded the June 14 planprovided some cushion but further measures are needed. Rationalization of the import regime could help while a trade loan (see Section 4) would ease the transition for the industrial sector from its privileged import subtituting status. Hopefully, this will avoid the excesses of the Martinez de Hoz "import promotion" period. Much of the "danger" of a fixed exchange rate has been reduced by the adoption of a pragmatic price/incomes policy. This provides an excellent countervailing instrument to any destabilizing price increases. Much of the potential inflation can be avoided if real wages are contained, however, this will also pose political difficulties. Hence productivity growth is needed.

In summary, what is needed is higher growth financed by monitizing external capital flows. This should be done while continuing with low budget deficits and concomitant low inflation rates. Increased productivity and hence sustained high rates of economic growth and enhanced debt servicing capacity can be achieved if the reform program outlined in the following section is adopted.

Assumptions for Projection

The principal external assumption are given in Table 4.1. These are common to both scenarios. Selected assumptions for the domestic economy for both the base and high cases are given in Table 4.2. In each scenario it is assumed that interest payments are made on schedule while amortization is rolled over (except short term).

Table 4.1 Assumption--External Common to Both Scenarios

	1970-80a/	1981	1983	1985	1986	1987	1988	1989	1990	85-90	90-95	85-95
Percentage Change per year												
GDP Growth in Industrial Countries (Real)	3.2	1.6	2.3	2.7	2.7	3.3	3.1	3.1	3.2	3.1	3.4	3.2
Europe	2.9	0	1.0	1.9	2.3	2.4	2.5	2.6	2.7	2.5	2.9	2.7
Asia	4.6	3.9	2.8	4.8	3.8	4.0	3.9	3.9	4.0	3.9	4.2	4.1
North America	3.1	2.6	3.5	2.6	2.6	3.9	3.4	3.3	3.3	3.3	3.5	3.4
US$ GDP Deflator for Industrial countries	10.1	-1.6	0.2	1.0	8.0	8.1	8.7	8.6	8.3	8.3	4.5	6.4
National Currency GDP Deflator for Industrial Countries	7.8	6.9	4.0	3.3	3.4	3.6	3.9	4.0	4.3	3.8	5.0	4.4
MUV Index (in US$)	12.3	0.5	-1.2	-0.5	7.0	7.0	7.5	7.7	7.6	7.4	4.5	5.9
Exchange Rate b/	3.2	-10.8	-3.6	-2.5	4.0	3.6	3.7	3.1	3.3	3.5	0	1.8
GDP Deflator for the U.S.	6.9	9.2	3.8	3.5	4.0	4.5	5.0	5.5	5.0	4.8	4.5	4.6
Non-oil Commodity Prices (Nominal)	12.3	-12.0	7.3	-9.1	2.9	9.0	9.0	9.1	9.3	7.8	5.1	6.4
Non-oil Commodity Prices (Real) c/	0	-12.5	8.6	-8.6	-3.9	1.8	1.3	1.4	1.6	0.4	0.6	0.5
Oil Prices (Nominal)	36.8	12.5	-12.3	3.5	3.3	5.2	5.2	5.3	5.0	3.4	8.6	6.0
Oil Prices (Real) c/	22.1	11.9	-11.3	-3.0	-9.7	-1.7	-2.1	-2.2	-2.4	-3.7	4.0	0.1
Average Annual Rate												
US Nominal Interest Rate d/	8.6	16.6	9.8	9.0	9.0	9.0	9.0	9.0	8.5	8.9	8.0	8.5
US Real Interest Rate e/	1.7	7.4	6.0	5.5	5.0	4.5	4.0	3.5	3.5	4.1	3.5	3.8

a/ Average rates for the period 1970-80 were calculated using geometric averages.
b/ The rate of change of the US$ GDP Deflator minus the rate of change of the US GDP Deflator. This represents the change in the real dollar exchange rate relative to all industrial countries currencies.
c/ Deflated by the MUV Index (= Unit Value Index of manufactured exports from industrial to developing countries).
d/ Six-month dollar LIBOR. Owing to the lack of historical data, the 1970-80 average uses three-month dollar LIBOR.
e/ The US nominal interest rate minus the rate of change of the US GDP deflator

External Financing

A preliminary estimate is given in Table 5.1 of external financing needs for the years 1986 and 1990 for both the base and the high cases. The principal difference between the two is that current balances are larger in the high case and this requires additional financings. This is shown under SHTERM as (net).

Table 5.1: External Financing Requirements Estimated, 1986-1990

(US$ millions current)

	Base Case		High Case	
	1986	1990	1986	1990
Res Bal	4093	6250	3441	5886
Net FSY	-5615	-6761	-5615	-6761
Current Balance	-1522	-511	-2173	-874
Capital Required				
CHRES	-50	-50	-50	-50
Direct Invest.	250	390	250	390
IMF Net	800	-400	800	-400
Net Official	423	416	423	416
Net Private1/	-21	-336	-21	-336
SHTERM (net)1/	120	491	771	855
	1522	511	2173	874

1/ Note much of the SHTERM could be private.

What Is Needed

This summarizes some of the main points underlying viable scenarios.

Base Case

1. Continuation of stable socio-political environment in order to sustain the Austral plan initiative.

2. External: OECD annual growth rates of 3 percent real, interest rates to remain at current levels or fall.

3. Domestic: Public sector deficit must remain at current levels less than the 2% of GDP and for the interim any deficits should be financed by monetizing external capital flows. As inflationary expectations are reduced, the Government might be able to move towards a more expansionary monetary policy to reduce real interest rates. This will have to be done on a gradual test and-see basis. This combined with adequate imports of capital and critical intermediate imports should facilitate growth. Alternately, reduced factor service payments could be used to free up resources for investment. An appropriate financing plan could possibly reduce factor service payments in the short term. Each percentage point reduction in interest charges would help increase funds available for investment (or alternate uses) by 0.6 percent of GDP.

4. Price/Wages/Exchange Rate: The current pragmatic approach to wage/price controls should continue, especially as a more expansionary monetary policy is introduced. This will be coupled with a reform of the banking system to reduce real interest rates. Wage increases should be linked to productivity increases. These in turn will come from improved sectoral policies (see Section 3 for details) and easier access to critial inputs.

5. Capital flows: The net capital flows required for the base case scenario are US$1.53 billion in 1986. This would drop to US$0.49 billion in 1990.

What is needed--High Case

1. In order to stimulate exports one needs to provide further incentives. These could include export insurance, forward exchange markets. In addition, one might give some thought to strengthening the export promotion institutions. In Argentina the production activities are much stronger than the marketing in a number of sub-sectors, and in such areas a specialized marketing operation, possibly trading houses, would be needed as part of overall improvement in the commercial policy. This can be helped by providing sufficient funds for working capital and adequate financing to cover the intervening period between production and export receipts.

2. Investment levels should be increased by providing increased credit at lower interest rates and focusing on those areas with high anticipated rates of return. This would include the energy and telecommunications sectors which could strengthen both public sector finances and infrastructure for the private sector. This might require substantial lending to the private sector with obvious implications for IBRD/IFC operations and also perhaps needing some sterilized intervention to avoid overheating of the economy.

3. Capital flows: There is also the possibility that direct investment flows may resume at higher levels. Preliminary data indicates that some of the capital flight may have been reversed. One has to seek measures to avoid the destabilizing effect of short term parking. It is possible that longer term capital flows might be stimulated by appropriate incentives/gurantees. The additional gross capital flows required will exceed the base case by US$653 milion in 1986. This figures would be US$1020 million in 1990.

4. Currently Argentina is under an IMF program (up to March 1986). It is the only major debtor country currently in compliance with an IMF program and also eligible for IBRD loans. This program places stringent limits on a number of macro variables. The scenarios in the study are in line with IMF public sector policies. However, IMF monetary guidelines may cause some problems if growth is to be resumed. It will also require some easing of IMF constraints on new external financing possibly before the end of the current program in March 1986.

GLOBAL/STRUCTURAL POLICY REFORM FRAMEWORK

1. This chapter identifies the major features that are necessary for a global/structural policy reform to resume and sustain medium term growth in Argentina. The purpose of the policy framework is to identify factors that have constrained growth, define policy objectives to eliminate such constraints, recommend specific policy changes, and indicate the possible effects of the proposed policy changes.

2. There are two major constraints for the resumption of sustained growth in Argentina: (a) the underlying distortions in the economy and (b) the inefficiencies in the operation of the public sector. Elimination of these constraints requires improving the incentives system necessary for a more intensive use of resources to increase production and exports, and undertaking a series of actions to improve the efficiency of the public sector. Carrying out these tasks will require the removal of distortions in the trade regime, appropriate liberalization of domestic pricing, restoration of domestic financial markets, the strengthening of the tax system and an overall improvement of the machinery of government, notably,sound public investment screening mechanisms, requiring public enterprises to operate like commercial entities, and defining an adequate framework for an expanded private sector role. Thus, this chapter is divided into two sections. Section I deals with the incentives system necessary for the resumption of growth and focusses on the elimination of distortions, reformation of domestic financial markets, and improvement of efficiency in the tax system. Section II deals with improving the efficiency of the public sector. It focusses on the public sector investment program, and on the energy and transport sectors which comprise over half of the public sector. It also examines the possibilities of restructuring and privatization of public sector industrial enterprises as a means to help reduce the Government's financial burden and public sector deficits, and to increase industrial efficiency, competitiveness and exports.

Phasing

3. Although the Government of Argentina has shown the courage and determination to adopt a serious and far-reaching shock-treatment stabilization program, a medium-term policy reform program will not be an easy task to undertake. Thus, the sequencing of policy reform will be important to focus first on those areas where the pay-off for policy reform is faster and larger. On the production side, output and export growth would mainly originate in three sectors: agriculture, manufacturing and energy. Policy reforms in these sectors should be pursued as rapidly as possible. In addition to macroeconomic considerations, setting these sectors in export oriented growth path will require substantial adjustments in policies.

4. However, trade policy reform is an extremely sensitive area. The previous import liberalization attempt was a bitter disappointment: entire industries disappeared, industrial employment declined in absolute terms, and small and medium scale industries were particularly hard-hit; and the country had nothing to show for it. For this reason, the proposed program of trade policy reforms focuses on achieving neutral status for export industries, shying away from a comprehensive tariff reform that would decrease average effective protection and its dispersion. This would be a way of maintaining the dialogue open on an issue whose sensitivity might diminish in a few years. Proceeding differently--that is to say, raising the isue of decreases in average effective protection at this point--would be extremely counterproductive. Argentine business and labour leaders would present a united front against. The investment climate, that the Government is painfully trying to reconstruct, would deteriorate sharply and the Bank's dialogue with the Government of Argentina would be seriously jeopardized.

5. Financial system reform has a very high priority and should follow. However, it is more difficult to implement and likely to be strongly resisted by the institutions least likely to survive, since restructuring will require bringing down the size of the banking system. Reforms of the public sector investment program planning process and of the tax system would follow those of the financial sector, except for the removal of export taxes on agriculture which should be undertaken as soon as possible. Measures to improve the efficiency of tax administration should be set in progress at an early date. Reforms of public enterprises in the transport sector should then follow. These are related to the Government's global adjustment efforts because these enterprises are an important drain on the Treasury's financial resources on account of their operating deficits and their investment programs; but, additionally, because their efficiency has an important bearing on the profitability of export oriented domestic productions (i.e. ports, railways). However, the institutional impediments to reform are substantial in the transport sector, and reform of necessity would be a drawn out process. Finally, privatization efforts in all sectors will be difficult. First, all enterprises are experiencing financial difficulties. Second, the private sector has been hard hit during recent years and does not have the resources for the acquisition and operation of these enterprises. Third, privatization is likely to resisted by some government groups. On the other hand, restructuring of the public sector industrial enterprises is likely to have a high payoff initially. This could then be followed at a later stage by privatization of some enterprises.

I. IMPROVING THE INCENTIVES SYSTEM

AGRICULTURE

A. Analysis

6. The agricultural sector has been growing below potential as a result of pricing policies that have: (a) have depressed domestic prices

for outputs through export taxes; and (b) artificially raised the costs of some key farm inputs through import tariffs and quantitiative restrictions. As a consequence, most farmers have opted for low-risk; lower-input technologies that have translated into a significant opportunity cost to the economy in terms of foregone production and export earnings.

7. Policy objectives in agriculture should focus on: (a) reducing export taxes on agricultural products; (b) providing alternative sources of fiscal revenue to compensate for the export tax reduction so as to maintain the overall fiscal deficit at satisfactory levels; and(c) rationalizing import laws and regulations on agricultural inputs.

B. <u>Policy Recommendations</u>

8. Specific changes recommended include:

(a) phased reduction of export taxes on agricultural commodities. The timetable of such an export tax reduction should include by: (i) January 1986, the removal of temporary increases imposed in June 1985; (ii) end 1986, the reduction of export taxes to no more than 70% of the rates in force on May 1, 1985; and (iii) January 1988, the reduction of export taxes to no more than 50% of the rates in force on May 1, 1985;

(b) introduction of a federal land tax and of alternative tax provisions to compensate for the revenue losses resulting from the export tax reduction program;

(c) removal of the temporary increases in import tariffs on agricultural inputs imposed in June 1985; and

(d) redesignation of tractors and agricultural machinery from the "prohibited" to the "prior approval" classification for imported goods.

C. <u>Quantification</u>

9. The policy reforms would stimulate increases in agricultural production and exports by: (i) increasing domestic producer prices, bringing them closer to international prices and improving benefit-cost ratios for investment and production inputs; and (ii) reducing the subsidy from producers to consumers. The introduction of a production-[illegible] federal land tax substituting for production negative export taxes would represent a structural change in Argentina's taxation system. The following projections result from the proposed policy changes:

(a) under the programmed reduction in export taxes of 50% of the May 1985 levels by 1988, an incremental 5.4 million tons of the five commodities produced and an incremental 3.9 million tons exported annually by 1990. With the exception of sorghum exports, both production and exports of all major commodities are projected to increase as export tax rates are reduced;

(b) the incremental net foreign exchange earnings from the five commodities under the programmed export tax levels would be about US$1.2 billion per annum by 1990 compared to the earnings at the higher tax rates. With the export tax rates held at 70% of the May 1985 levels, the incremental net foreign exchange earnings would be about US$800 million; and

(c) the reduction in export taxes would reduce the implicit subsidy from producers to consumers. The increase in consumer expenditures brought about by the reduction of export taxes would be about 1% for the highest income group and about 1% for the lowest income group. As only about 27% of the five major crop commodities are consumed locally, the total income transfer from consumers to producers would be limited. The effect on consumer prices would not be important.

MANUFACTURING

A. Analysis

10. Argentina's manufactured exports have been influenced substantially by the overall trade regime, which has, in the last five decades, been largely protectionist, creating a strong inward-looking bias in the economy. Industrial export promotion has been generally seen as secondary to import-substituting industrialization. As a number of incentives and disincentives for different products were introduced, a multiplicity of effective exchange rates emerged, with exports of traditional goods receiving the lowest rates. The system ultimately succeeded neither in eliminating the anti-export bias in the highly protected industries nor in sustaining the traditional manufacture and agriculture. The incentives regime was rendered particularly inadequate during the 1977-81 import liberalization attempt. Argentina's manufacturing sector is still badly shattered by that unfortunate import liberalization experience, adopted concurrently with a revaluation of the domestic currency.

11. Manufacturing offers good prospects for export oriented output growth, with attendant foreign exchange earnings and employment creation. The sector lacks a clear development strategy, institutional support and consistent policy signals. The main issue is how to redress the strong anti-export bias built onto the complex systems of tariff and non-tariff protection while maintaining an exchange rate adequate enough to restore export competitiveness. Policy objectives in manufacturing should focus on the implementation of an outward looking development strategy by introducing reforms to reorient the economy towards export promotion. This should include: (a) phased elimination of import prohibitions and quantitative restriction, and of export restrictions; (b) reorientation of

export policies so as to reduce the discretionary element and provide automaticity and uniformity of access to incentives and foreign exchange in order to provide neutral status for export industries; (c) improvement of the administrative mechanisms of trade management; and (d) preparation of studies on tariff protection and rationalization of the system of tax rebates to exports as a basis for further policy reforms.

B. Policy Recommendations

12. Specific changes recommended include:

(a) the gradual elimination of most import licensing requirements as follows: (i) reclassification of about 4,000 (100%) tariff positions from prohibited to free, with introduction of additional (equivalent) tariff protection; and (ii) gradual reclassification of about 1,300 (100%) tariff positions from prior consultation to free, with introduction of additional (equivalent) tariff protection;

(b) achievement of neutral status for export industries, through the reform of the temporary admission regime for imported inputs as follows: (i) simplification of administrative procedures; (ii) guarantee of automatic access for any products; (iii) coverage of indirect exporters; (iv) extension to capital goods used for export production; and (v) extension of the tax reimbursement scheme to exports processed under the temporary admission regime;

(c) simplification of export procedures, eliminating all unnecessary interventions by public sector agencies; and

(d) preparation of the following studies needed to support the adjustment process: (i) tariff protection, with a view to actions that will reduce tariff dispersion; and (ii) the indirect tax content of exports, with a view to actions to rationalize the system of tax rebates to exports, as well as to strengthen it vis-a-vis trading partners that might be tempted to impose countervailing duties.

C. Quantification

13. The following projections for 1986-90 reflect the potential impact of the proposed policy changes: (a) exports of manufacturing goods would grow on average by about 7.2% in real terms during 1986-90, from 4.3% in 1984; (b) imports of goods would grow on average by about 5.7% in real terms on average during 1986-90, from about 4.4% in 1984; and (c) the current account deficit of the balance of payments would fall from US$2.5 billion in 1984 to an estimated US$2.2 billion in 1986 and to about US$800 million in 1990.

FINANCIAL SYSTEM

A. Analysis

14. The effectiveness and efficiency of the financial system will be a key element in the speed and effectiveness of the recovery in Argentina. Once the economy has reached capacity in the productive sectors, the availability of credit at realistic interest rates will be the key to stimulating investment in future productive capacity. The financial sector, having been severely battered over the past decade, is in a poor position to provide the type of efficient service that the economy is going to need. It is currently characterised by substantial overexpansion and by interest rate spreads of as much as 4% real per month reflecting not only an overall scarcity of funds, but more importantly, substantial inefficiencies in the system itself. Even with more normal levels of money supply in the economy, it is estimated that financial institutions would need spreads of 1.5% to 2% per month to break even. In effect, the system has operated like an oligopoly, despite the large number of participant institutions, protecting the least efficient ones and guaranteeing large economic rents to the more efficient ones. Analysis of the sector also indicates that low productivity is not confined solely to small institutions and that a policy of encouraging mergers will not, in itself, solve the problem. other factors working to increase interest rate spreads include the 2% surcharge used to finance the Institute of Social Services for Bank Employees (ISSBE), the CRM (a device to reallocate the burden of differential reserve requirements) and various mechanisms to direct credit.

15. The goal of the reform of the financial sector should be to achieve conditions such that spreads between the deposit rate and the lending rate should be no more than 4%. This then will allow interest rates which are both attractive to depositors while not being so prohibitive to producers so as to discourage investment in new plant and equipment and in stocks.

B. Policy Recommendations

16. While a return to more normal levels of money supply in relation to GDP will certainly help to create a more healthy financial sector, there are a number of specific policy measures that must be taken within the sector itself:

(a) restructuring of the sector by means of (i) increasing the minimum capitalization required for a financial institution; (ii) enactment of legal maximum spreads between the deposit and the lending rate with a time phsed lowering of these limits; (iii) temporary fiscal measures to encourage consolidation; and (iv) a program aimed at public as well as private banks and at large as well as small;

(b) removal of the ISSBE surcharge and its coverage by alternate fiscal measures;

(c) focussing of reserve requirements on sight deposits with a very low requirement, say 10%, on time deposits;

(d) removal of the CRM recognizing that its control function is only required in periods of high instability and that its allocative function has never worked efficiently; and

(e) elimination of all credit subsidies in any context.

C. Quantification

17. The above reforms should be sufficient to lower real interest spreads and return them to levels where they make economic sense. Only the restructuring of the banking system will take any time. Thus in quantitative terms, real interest spreads should, by the end of 1986, have fallen to the region of 6% annual. This then should reinforce the consolidation trend in the industry which, when it is complete, say by late 1987 or early 1988, should allow the goal of a 4% maximum spread to be a reality.

TAX ISSUES

A. Analysis

18. Argentina's tax structure is basically sound and appropriate for its level of development, including taxes on income, wealth, and value added. It has, however, been characterized in recent years by high volatility with respect to GDP, poor administration, widespread leakages through exemptions, and a buoyancy of less than unity with respect to GDP. Total taxes collected are only about 20% of GDP and have been so for many years. Income taxes amount to only 1.5% of GDP, and the value added tax (VAT), in spite of the 18% rate, only 3.5% of GDP. Customs and excises are too high a share of revenues for a country of Argentina's level of development and create significant distortions both on the supply and on the demand side of the economy.

19. Policy objectives in the tax area should focus on increasing the yield from the existing structure and on shifting the burden to income, value added, and wealth taxes. The most important area for improvement is tax administration and there is strong evidence that it has been hampered by frequent tax changes, repeated amnesties, and by penalty interest rates often substantially below the taxpayer's cost of capital. Argentina's goal should be to raise the tax ratio to 25% of GDP and this should be accomplished within the existing tax structure with a major emphasis being placed on sweeping elimination of exemptions to taxation. In addition, effort needs to be placed on improved administration and information flows.

B. Policy Recommendations

20. Specific changes recommended include:

(a) taxes on foreign trade: to be eliminated for industry, significantly phased out in agriculture, and replaced by production-neutral taxes;

(b) property taxes: to initiate the steps necessary for a production-neutral federal land tax, including an accurate cadastre;

(c) administration: (i) to improve information flow by unification of taxpayer identification for each separate tax collecting entity; (ii) phase out expensive "visit" system in favor of distribution of information on "cross compliance"; (iii) concentrate audit efforts on VAT; (iv) penalties for evasion to be sharply increased (iv) ensure that penalty interest remains significantly above taxpayers cost of capital; and (v) abolition of amnesties;

(d) income taxes (corporate): to be left largely as is except to (i) broaden tax base; and (ii) include profits on the sale of rural properties;

(e) wealth taxes: (i) to be extended (due to run out in 1985) as is; and (ii) to eliminate deduction of 50% of assessed value of agricultural property;

(f) taxation on goods and services: (i) turnover tax to remain unchanged; and (ii) in VAT eliminate most of exemptions given for industrial incentives purposes; and

(g) excise tax: (i) not to be broadened; and (ii) focus on commodities where government has direct control over the collection (e.g. gasoline).

C. Quantification

21. The overall target would be for tax revenues to gradually reach 25% of GDP by 1990, a level which would be adequate to allow for real increases in public services and an increasing contribution of government savings to investment. Key structural changes include an increase in yields of income tax, the introduction of a land tax, phasing out of most taxes on foreign trade, narrowing excise taxes, and strengthening the VAT. In this connection, social security taxes have recently been raised.

II. IMPROVING THE EFFICIENCY OF THE PUBLIC SECTOR

PUBLIC SECTOR INVESTMENT AND FINANCING

A. Analysis

22. Since 1977, public investment has declined by 60% in real terms. In recent years, the Government has encountered difficulties cutting current expenditure and has resorted to sharp cuts in investment. The cuts have been made haphazardly, and essential services have deteriorated. The critical areas requiring immediate attention are the following:

(a) port services are not adequate for an expanded volume of grain exports. The bottlenecks are likely to become more serious if exports continue to expand;

(b) exploration and exploitation of hydrocarbon resources have fallen behind the country's estimated potential. As soon as the economy recovers, consumption will increase and the country will face the danger of becoming an importer of hydrocarbons;

(c) roads feeding main transport corridors are either lacking or have deteriorated seriously. The agricultural export potential (especially fruits/vegetables) is not being fully exploited because of high transport costs/quality deterioration resulting from incomplete/bad feeder roads; and

(d) the telecommunications network is inadequate to meet the needs of business and residential users. Waiting lines for telephone installation stretch to 5-7 years, raising operating costs significantly

B. Policy Recommendations

23. Specific changes recommended include:

(a) rapid completion of dredging and the reconstruction of hinterland services at the Bahia Blanca port; and encouragement of private sector to build river ports;

(b) concentration of YPF's (the State Oil Company) resources on oil exploitation and liquid extraction, gas gathering and enhanced oil recovery projects; and accelerating the projects of oil and gas pipeline construction, particularly those for Formosa oil fields and for Lujan de Cuyo;

(c) increased emphasis on road reconstruction and maintenance and gravel surfacing on roads with more than 100 average daily traffic; shifting railway transport operations to bulk freight with unit trains over a basic network of 16,000 km; emphasis on railway track renewal and bridge/culvert construction; and

(d) encouragement of private sector participation in the provision of telephone services.

24. The public investment budget will continue to be tight in the foreseeable future. At the same time, average public tariffs for users have already reached -- with the exception of electricity -- a level above which Argentine producers' international competitiveness could be negatively affected. Therefore, priority investments will increasingly have to be financed from:

(i) productivity increases: (i) reduction of public employees through attrition (as much as 10% per year); (ii) adequate wage differentiation and production incentives; (iii) reinforcement of managerial accountability and introduction of cost accounting in public enterprises; (iv) cutting uneconomic production and transport losses; and (v) restructuring of some enterprises to expose them to competition;

(ii) revenue sharing: (i) elimintion of earmarked funds for non-priority projects; (ii) allocating to enterprises a higher percentage of tariffs paid by users, as the Treasury rebuilds its own revenue sources; and (iii) real increases in water and electricity tariff revenues;

(iii) actions on non-priority investments: (i) in the energy sector minimization of coal investments and postponement of major hydroelectricity projects; (ii) in road transport, reduction of investments in upgrading/capacity, and decreases in "strategic" roads with very low traffic and in new paving; (iii) in railway transport, elimination of new electrification schemes, and reduction of investments in passenger traffic; (iv) in maritime transport slowing down the expansion of the merchant fleet; and (v) in industry, cancellation of the expansion of the petrochemical production capacity in Bahia Blanca, of the new sheet steel rolling mill by SOMISA, and of the shipyards expansion.

ENERGY

A. Analysis

25. Falling proven oil reserves and heavy reliance on petroleum as the primary energy source jeopardize Argentina's self-sufficiency in liquid fuels. Substantial new drilling is needed to maintain production in order to avoid imports. Proven and potential reserves of gas are almost twice as important as those of oil, but increased use of gas (including its possible export) is constrained by the limited transport infrastructure.

Rationalization of oil and gas development requires more attractive and stable incentives for the private sector, clarification of the latter's role vis-a-vis theGovernment's, bringing absolute as well as relative prices of hydrocarbon products more in line with the economic cost of fuels, and strengthening public sector agencies in the energy sector, notably their financial condition and planning framework.

26. The Government's past objectives for the oil and gas sector focussed on exploration and production of oil to assure self-sufficiency and substitution of relatively abundant gas for liquid fuels. Energy conservation received little attention. However, the petroleum sector has the potential not only to assure the country self-sufficiency in oil but also to produce significant surpluses for export. At the same time, it would be imperative to continue to promote the substitution of gas for liquid fuels based on a significant expansion of gas transmission infrastructure during the next three to four years. Over the medium and longer term, Argentina's oil and gas reserve base could be expanded and important energy conservation efforts should be supported.

27. Policy objectives on oil and gas should focus on: (a) infrastructure development; (b) defining an adequate framework for an expanded private sector role; (c) rationalization of pricing and taxation; (d) financial and institutional restructuring of major public enterprises in the energy sector; and (e) launching of an energy conservation program.

B. Policy Recommendations

28. Specific changes recommended include:

(a) infrastructure: (i) government decision on the expansion of the gas transportation system (and corresponding gas gathering, treatment, and distribution through significant private sector (local and foreign) participation. Specifically, whether to expand the Central-West pipeline or to construct a new pipeline from Neuquen via Bahia Blanca to Buenos Aires; and (ii) solution of the COGASCO dispute would also be an integral part of this decision;

(b) private sector role: (i) encourage private sector participation by awarding new exploitation contracts to private firms which hve the financial and managerial capabilities to supplement YPFs efforts, and new exploration contracts to expand oil and gas reserves; (ii) avoid excessive reliance upon public enterprises for exploration and production of energy products and increase private sector participation by reducing YFP's investment program; and (iii) limit or eliminate convertibility risks (i.e. exports of products as guarantee for foreign currency obligations) and facilitate access to domestic credit (i.e. "apex" financing arrangements to support private sector borrowing needs);

(c) public enterprises: (i) financial strengthening and organization and streamlining of YPF and Gas del Estado (GdE), including reviews of their organization structure, accounting, and control systems;

(d) pricing and taxation: (i) adjust the price of natural gas as a function of its long run opportunity cost; (ii) adjust the price of diesel as a function of the regular gasoline energy equivalent; (iii) review the level and structure of prices of other energy products; (iv) review relationship with energy conservation incentives; and (v) review the costs and benefits of the existing structure of taxation and of the energy sector with a view to increasing efficiency;

(e) conservation: (i) design and implement an energy conservation program including pricing and taxation aspects; and (ii) study of the energy efficiency of the power sector and of the possibilities for end-user conversion and savings.

C. Quantification

29. Official reserve estimates assume that only 19% of the oil in the ground may be recovered. This appears low by international standards. It may well be that a recovery rate of around 25% or more is possible. This would increase proven reserves fron around 370 million cubic meters to over 600 million cubic meters of oil and would allow exports of crude oil or petroleum products of around 70,000 - 100,000 barrels per day amounting to US$0.7 - 1.0 billion. New resource discoveries combined with energy conservation efforts should allow Argentina to maintain self-sufficiency in energy use for the next two or three decades.

30. Annual investments of US$1 billion or more would be required in the petroleum sector and around US$500 million annually for gas transmission and distribution over the next five years. Under the foreseeable constraints on government investment funds, neither YPF nor GdE will be able to finance such programs on their own, nor would they have the capacity to implement them. However, by involving the private sector and by using new financing instruments such as project financing and funds from international development banks, implementation of such investment programs could be feasible even in the present environment of tight public investment funds. The efficiency of these undertakings could be significantly improved by restructuring YPF and by deregulating the present pricing policy framework in the petroleum sector. YPF's investment program which was already reduced from a high of US$1.8 billion in 1980 to about US$900-1000 million (including dry wells) in 1985 could be further reduced to around US$600 million by the late 1980s. The offering of areas for exploration to private sector firms could reduce investment needs for YPF by US$100-200 million per annum. But even then, significant investments would be required to achieve a rapid increase in oil production. New exploration contracts could decrease YPF's investment requirements for production and provide the capacity to achieve the export targets mentioned above before the end of the decade. US$200-300 million of investments per year would appear to be an achievable target for private sector production activities.

TRANSPORT SECTOR

A. Analysis

31. Public enterprises in the transport sector are an important drain on the Treasury's financial resources on account of their operating deficits and their investment programs. At the same time, their efficiency has an important bearing on the profitability of export oriented domestic production (i.e. ports, railways).

32. The sector is beset by bottlenecks and idle capacity which go side by side as a result of poor resource allocation and disinvestment, serious deterioration of infrastructure, poor maintenance, and obsolescence of rolling stock and fleet. Planning systems are inadequate and poor. There is little intermodal coordination; responsibilities of transport agencies are unclear, and the roles of the public and private sectors remain largely undetermined. Funds are earmarked for specific modes of transport or institutions without taking into account demand and rate of return criteria. Staffing and information are inadequate. The Ministry of Public Works and Services (WPSP) lacks systematic flows on project information and follow-up actions. In recent years there has been a major loss of experienced and trained staff while underemployment of lower level personnel has increased.

33. Policy objectives in transportation should focus on: (i) measures necessary to allow public enterprises to operate like commercial entities. This includes increasing prices of public sector services, and ensuring adequate cost recovery in such areas as road uses costs, port tariffs, dredging costs, and railroad and airline tariffs, and (ii) policies to improve sector planning, investment follow-up, reduce public sector requirements through increased private sector participation, and deregulate and privatize transport sector activities.

B. Policy Recommendations

34. Specific changes recommended include:

(a) increased prices of public sector services to ensure adequate cost recovery in such areas as road user costs, port tariffs, dredging costs, and railroad and airline tariffs;

(b) improvement of efficiency of operation of the railways. This should include: (i) reduction of manpower (currently 108,000), closure of economic lines, generation of operation/line-specific economic information to allow the assessment of the merits of expenditure programs; and overall reduction of the 1986-90 investment expenditures by 60%; and (ii) shift in investment priorities: from passenger traffic to bulk freight (using unit trains over a basic network of 16,000 km); from the expansion of rolling stock (limiting purchases to replacement needs) and new electrification schemes to tract renewal and bridge culvert construction; and from "administrative" investments to control of operations, including the coordination of broad-gauge lines;

(c) improvement of efficiency of operation of maritime and air transport. This should include: (i) reduction in total investment expenditure; introduction of a roll system to cover major reequipment costs; efficiency improvements in ort dredging operations; and elimintion of legal obligations to buy from domestic shipyrds; and (ii) shifts in investment priorities from the expansion of the merchant fleet to dredging and port support services and elevators, and from a possible airfleet standardization investment to the extension of landing strips and the improvement of air traffic control systems;

(d) strengthening of MOSP planning and follow up including the restoration of national transport planning as part of the global public investment planning mechanism, and the elimination of earmarked funds. In most road transport, priorities need to be shifted (i) from upgrading/capacity increases to reconstruction (current investment projects allocate 73% and 26%, respectively, to the former and the latter); (ii) from projects that are not likely to yield acceptable rates of return (due to expected traffic levels below minimum), that are allocated 52% of total investment expenditure, to higher traffic corridors; and (iii) from new paving projects with expected average daily traffic (ADT) of less than 100 to gravel surface projects between 100 and 400 ADT;

(e) initiation of institutional reforms such as consolidation of port agencies and urban rail authority, and agreement on studies to implement action programs in the sector; and

(f) deregulation and privatization in areas of offshore storage/shipping facilities, containerization, tugboat service, and highway maintenance.

C. Quantification

35. Action on the above areas would result in a more efficient and less costly trnsport operation in support of Argentina's export promotion efforts. At the same time, the negative effects on the overall public sector deficit will be significantly reduced.

RESTRUCTURING AND PRIVATIZATION

A. Analysis

36. Restructuring and privatization of public sector industrial enterprises provide a further means to help reduce the Government's financial burden and public sector deficits and to increase industrial efficiency, competitiveness and exports. These are important areas of policy consideration because future growth possibilities of the Argentine economy may hinge critically on the ability of the Government to keep down

public sector expenditures and deficits, which otherwise could lead to uncontrollable upward pressures on inflation, interest rates and/or taxes.

37. Policy objectives in restructuring and privatization should focus on: (a) restructuring of public sector enterprises which often have large potential for cost reductions or which, through their linkages, could have a significant impact on the efficiency and competitiveness of other parts of the industrial sector as well as the rest of the economy; and (b) privatization of select state owned enterprises.

B. Policy Recommendations

38. Specific actions recommended include:

(a) programs to support technical, financial and organization/management restructuring of selected parastatal enterprises or subsectors would help to improve the efficiency and competitiveness of basic industries. The most promising candidates are: (i) steel (mainly SOMISA--to help cut costs, balance production lines and strengthen management/administrative practices); and (ii) telecommunications (ENTEL--to improve operational and managerial efficiency). Systematic restructuring/rationalization should focus on improvements in: (i) organizational structures and management and administrative processes (including the degree of their autonomy and the nature of their relationship with the Central Government); (ii) balancing and/or modernization of existing production lines; (iii) production management techniques (e.g., inventory and other working capital management, appropriate balance between production capacity and size and composition of work force; (iv) financing; and (v) pricing/cost recovery techniques; and

(b) mounting a comprehensive program for privatizing public enterprises in the prodcutive sectors (e.g. petrochemicals) as well as in services/infrastructure which should include: (i) the identification of potential local and foreign private sector investors who would be interested in the purchase of state owned assets; (ii) the sale price value of the assets to be negotiated between government and private sector buyers; and (iii) the vehicle of transfer of assets to private investors, e.g. stock market, international competitive bidding, etc.

C. Quantification

39. The steel and telecommunications sectors present the best opportunities of potential benefits of restructuring/privatization actions through cost reductions and efficiency components as well as through linkage and potential impacts on the competitiveness of other productive subsectors. The efforts toward privatization could, in the near term, help reduce the public sector deficit and, thus, support the Government's stabilization objectives. In the longer term, through better exploitation of the benefits of private initiative and entrepreneurship, they could also lead to significant efficiency improvements in many segments of the economy, help stimulate direct foreign investment, and facilitate export development.

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ARGENTINA: IN SEARCH OF GROWTH

Edgardo Barandiaran
November 25, 1985

This paper discusses the current state of the Argentine economy with the purpose of identifying the critical factors that are preventing sustainable growth. In Section I the contraction of 1980-84 is analyzed from a long-run perspective. I claim that the increasing disruption of the political system since 1930 has been decisive for the poor long-run performance of the Argentine economy. After 1970 that disruption took new force and direction with major economic consequences.

In Sections II and III the analysis centers on two of those consequences: the accumulation of debt and the acceleration of inflation. As shown in Section II that accumulation has implied a severe burden to the relatively closed Argentine economy and the service of the debt has become a constraint on growth. Debt restructuring has been alleviating this burden, but it still is too large. As discussed in Section III, inflation became the main economic sympton of an unsettled political system, which has increasingly failed to maintain some minimum fiscal and monetary discipline and exacerbated the struggle over income shares. In June 1985, the Argentine Government finally reacted to the threat of hyperinflation by implementing the "Plan Austral". In Section III, I discuss the program and the results of the first five months of its implementation.

I conclude that the policy output from the unsettled political system is the critical constraint for economic growth and that additional debt relief is very likely to aggravate the burden of debt, with no significant impact on growth. Only upon the settlement of the political system that constraint can be removed and stabilization be durable. Immediately, the Argentine political system faces the challenge of consolidating stabilization. Steady progress in this direction will be an indicator that Argentina is starting to settle her political system.

In the two appendices I analyze the second stage of the Austral Plan, which must be implemented during the next four months, and some quantitative projections of output growth and debt in different scenarios.

I. LONG-RUN STAGNATION AND THE CONTRACTION OF 1980-84

1. In 1980-84, the absolute decrease in output and the evolution of other economic indicators point to some kind of collapse. This performance has not parallel in the history of Argentina, even though it may be viewed as the final stage of a long period of stagnation. A quick review of output growth in this century (Table 1) indicates at least four periods:

(a) Up to 1930 Argentina could absorb a large immigration while output per capita increased at a high rate relative to other countries. In 1929 output per capita was half of that in the United States and 3.6 times greater than in Brazil.

(b) Between 1930 and 1955, output per capita increased at a lower rate than in the previous period, but the relative position of Argentina did not deteriorate. Argentina suffered as much as other countries during the Great Depression, but the war affected her very little.

TABLE 1. ARGENTINA. GROWTH AND INFLATION

	Total GDP			GDP per Capita			Annual Inflation (%)	
		% Annual Change with Respect to			% Annual Change with Respect to			
	1914 =100	previous period	1900-1904	1914 =100	previous period	1900-1904	Consumer prices	Wholesale prices
1900-04	56.7			93.0			-	-
1905-09	83.8	8.12	8.12	115.6	4.44	4.44	-	-
1910-14	104.9	4.59	6.35	114.0	-0.27	2.06	-	-
1915-19	100.8	-0.79	3.91	94.9	-3.60	0.13	9.92	-
1920-24	134.3	5.91	4.41	112.2	3.40	0.94	-2.60	-
1925-29	174.9	5.42	4.61	125.8	2.31	1.22	-1.34	-
1930-34	178.5	0.45	3.90	113.7	-2.01	0.67	-4.84	-
1935-39	209.5	3.26	3.80	122.4	1.49	0.79	3.54	-
1940-44	241.9	2.92	3.69	130.2	1.25	0.84	2.25	10.93
1945-49	300.5	4.43	3.78	147.9	2.59	1.04	18.87	13.18
1950-54	331.2	1.96	3.59	146.1	-0.24	0.91	20.77	22.02
1955-59	397.2	3.70	3.60	159.6	1.78	0.99	34.90	39.11
1960-64	456.3	2.81	3.54	168.7	1.12	1.00	22.90	21.55
1965-69	565.2	4.37	3.60	191.7	2.59	1.12	21.33	16.77
1970-74	664.6	3.29	3.58	212.0	2.03	1.18	38.14	38.38
1975-79	740.3	2.18	3.49	216.3	0.40	1.13	213.66	205.94
1980-84	736.8	-0.09	3.26	197.5	-1.81	0.95	222.82	232.51
1975	716.1	-0.39		216.8	-2.12		182.8	192.5
1976	712.8	-0.46		212.0	-2.21		444.1	499.0
1977	758.2	6.37		221.6	4.53		176.2	149.4
1978	732.6	-3.38		210.4	-5.05		175.4	146.0
1979	781.8	6.72		220.6	4.85		159.5	149.3
1980	787.3	0.70		218.4	-1.00		100.8	75.4
1981	738.5	-6.20		201.2	-7.88		104.5	109.6
1982	700.1	-5.20		187.3	-6.91		164.8	256.2
1983	721.8	3.10		189.7	1.28		343.8	360.9
1984	736.2	2.00		190.7	0.53		626.7	573.3

Source:
Prepared with data from M.A. Broda y Asociados.

By 1955 growth was already lagging vis a vis the recovery of industrial countries and the development of other Latin American economies.

(c) Between 1955 and 1970, output per capita increased at a high rate in comparison with the two previous periods, but that performance was very poor in relation to the rest of the world. The relative decline of Argentina, which has started around 1950, was substantial with respect to other developing countries; for example, while in Argentina output per capita increased 40% between 1950 and 1970, in Brazil it doubled.

(d) Since 1970, output per capita increased first at a declining rate and finally has decreased to its 1965-69 level. The deterioration vis a vis other countries has been extraordinary. In 1981, output per capita was only 20% of that in the United States and 15% higher than in Brazil.

2. Between 1950 and 1980, the path of most economic aggregates was consistent with the low growth in output, but there were some breaks first after 1955 and then after 1970. Trends in income and absorption were in line with the trend in output during 1950-80 (Table 2), but there were a number of short-lived imbalances that called for stabilization programs. After 1955 growth in output accelerated and there was a significant change in the composition of domestic absorption (Table 4). The increase in investment, financed by domestic savings, was important and the marginal productivity of capital did not decline (Table 13). The composition of output continued shifting in favor of manufacturing industry, but agriculture and other primary activities started to recover (Table 3). In the 1970s there was no change in

TABLE 2. ARGENTINA. NATIONAL ACCOUNTS: GROSS DOMESTIC PRODUCT (GDP), GROSS NATIONAL PRODUCT (GNP) AND DOMESTIC ABSORPTION

	GDP Millions A$1970	GNP Millions A$1970	GNP % GDP	Domestic Absorption Millions A$1970	Domestic Absorption % GDP	Domestic Absorption % GNP
1950-54	4766.5	4757.8	99.8	4815.9	101.1	101.2
1955-59	5713.3	5699.5	99.8	5747.9	100.6	100.8
1960-64	6576.1	6530.3	99.3	6592.5	100.2	101.0
1965-69	8132.5	8036.2	98.8	7973.9	98.0	99.2
1970-74	9397.1	9282.8	98.8	9398.5	100.0	101.2
1975-79	10446.8	10338.8	99.0	10220.0	97.8	98.9
1980-84	10397.1	9851.8	94.8	10239.6	98.5	103.9
1975	10105.3	10035.8	99.3	10275.0	101.7	102.4
1976	10058.4	9913.6	98.6	9762.4	97.1	98.5
1977	10699.5	10577.5	98.9	10339.7	96.6	97.8
1978	10338.8	10230.4	99.0	9800.0	94.8	95.8
1979	11032.2	10936.8	99.1	10922.6	99.0	99.9
1980	11114.2	11002.3	99.0	11565.0	104.1	105.1
1981	10421.2	10139.0	97.3	10708.9	102.8	105.6
1982	9878.6	9181.0	92.9	9461.6	95.8	103.1
1983	10182.0	9357.1	91.9	9606.8	94.4	102.7
1984	10389.5	9579.4	92.2	9856.0	94.9	102.9

Source:
Central Bank of Argentina.

TABLE 3. ARGENTINA. GDP AND EMPLOYMENT: SECTORAL COMPOSITION

	Agriculture	Mining	Manufacture	Construction	Services
			GDP (%)		
1950-54	18.8	0.7	27.7	4.5	48.3
1955-59	17.7	0.7	30.6	3.9	47.1
1960-64	16.3	1.1	31.2	3.7	47.7
1965-69	14.9	1.4	34.1	3.8	45.8
1970-74	13.2	2.3	27.9	6.1	50.5
1975-79	13.6	2.3	26.7	6.8	50.6
1980-83	14.3	2.7	23.5	5.7	53.8
			EMPLOYMENT (%)		
1960	20*		28	6	46
1970	16*		21	9	54
1980	13*		21	11	55

* All primary activities.

Sources:
Central Bank of Argentina and INDEC.

TABLE 4. ARGENTINA. NATIONAL ACCOUNTS: CONSUMPTION, INVESTMENT, AND SAVINGS

	Consumption		Investment		Domestic Savings		Foreign Savings	
	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP
1950-54	4035.8	84.7	780.1	16.4	722.1	15.1	58.0	1.3
1955-59	4834.5	84.6	913.4	16.0	864.9	15.1	48.5	0.9
1960-64	5265.2	80.1	1327.3	20.2	1265.1	19.2	62.2	1.0
1965-69	6401.3	78.7	1572.6	19.3	1636.7	20.1	-64.1	-0.8
1970-74	7406.0	78.8	1992.5	21.2	1876.9	20.0	115.6	1.2
1975-79	7943.2	76.0	2276.8	21.8	2395.5	22.9	-118.7	-1.1
1980-84	8456.8	81.3	1782.8	17.1	1395.3	13.4	387.5	3.7
1975	8233.2	81.5	2041.8	20.2	1802.6	17.8	239.2	2.4
1976	7589.0	75.4	2173.4	21.6	2324.6	23.1	-151.2	-1.5
1977	7745.0	72.4	2594.7	24.3	2832.2	26.5	-237.5	-2.2
1978	7599.5	73.5	2200.5	21.3	2630.9	25.4	-430.4	-4.2
1979	8549.4	77.5	2373.2	21.5	2387.4	21.6	-14.2	-0.1
1980	9020.7	81.2	2544.3	22.9	1981.6	17.8	562.7	5.1
1981	8752.4	84.0	1956.5	18.8	1386.6	13.3	570.0	5.5
1982	7804.7	79.0	1656.9	16.8	1375.5	13.9	281.4	2.9
1983	8090.1	79.5	1516.7	14.9	1269.4	12.5	247.3	2.4
1984	8616.0	82.9	1240.0	11.9	963.4	9.3	276.6	2.6

Source:
Central Bank of Argentina.

the composition of domestic absorption but the marginal productivity of capital declined substantially. In addition, the decline of manufacturing industry implied a significant shift in the composition of output and employment (Table 3). These changes were indicating that the declining trend in output growth would continue in the 1980s, but there was no evidence about the possibility of a sharp contraction.

3. Between 1950 and 1980, there were no major changes in the role of the external sector at the aggregate level, regardless of the extensive discussion about trade and financial policies. Only between 1955 and 1970, the ratios of exports and imports to GDP increased slightly (Table 5), but they continued being very low in relation to the 1920s. Exceptionally the current account deficit was significant (in 1951 and 1961 and to a less extent in 1952, 1955, 1971 and 1975); in fact, the current balance did not show any trend (Tables 5 and 6).

4. Between 1950 and 1980, there was a significant increase in the size of the public sector (defined broadly as in Tables 9 and 10). However, all this increase took place after 1970. Between 1955 and 1965, there was some contraction in the public sector as a reaction to its fast growth in the previous 15 years. Since 1970, the increase in total expenditures has been substantial, but not continuous. The immediate causes of this increase have been the social security system (line "Transfer" in Table 9), the current expenditures of public enterprises (most of "Goods and services" in Table 9), and the capital expenditures of all the public sector. The growing difficulties to finance the public sector resulted in a huge expansion of debt and consequently in an increase in interest payments. In the 1950s the size

TABLE 5. ARGENTINA. NATIONAL ACCOUNTS: EXPORTS, IMPORTS AND FACTOR INCOME

	Exports		Imports		Net Factor Income		Current Account	
	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP
1950-54	470.5	9.9	519.9	10.9	8.7	0.2	-58.1	-1.3
1955-59	565.9	9.9	597.6	10.5	16.9	0.3	-48.6	-0.9
1960-64	708.9	10.8	734.6	11.2	36.6	0.6	-62.3	-1.0
1965-69	904.8	11.1	746.2	9.2	94.5	1.2	64.1	0.8
1970-74	788.1	8.4	807.4	8.6	96.2	1.0	-115.5	-1.2
1975-79	1110.6	10.6	883.7	8.5	108.0	1.0	118.8	1.1
1980-84	1374.8	13.2	1217.3	11.7	545.3	5.2	-387.8	-3.7
1975	737.4	7.3	907.1	9.0	69.5	0.7	-239.2	-2.4
1976	970.5	9.6	674.5	6.7	144.8	1.4	151.2	1.5
1977	1227.7	11.5	868.2	8.1	122.0	1.1	237.5	2.2
1978	1322.5	12.8	783.7	7.6	108.4	1.0	430.4	4.2
1979	1294.8	11.7	1185.2	10.7	95.4	0.9	14.2	0.1
1980	1242.1	11.2	1692.9	15.2	111.9	1.0	-562.7	-5.1
1981	1340.3	12.9	1628.1	15.6	282.2	2.7	-570.0	-5.5
1982	1359.1	13.8	942.9	9.5	697.6	7.1	-281.4	-2.9
1983	1476.1	14.5	898.5	8.8	824.9	8.1	-247.3	-2.4
1984	1457.8	14.0	924.3	8.9	810.1	7.8	-276.6	-2.6

Source:
Central Bank of Argentina.

TABLE 6. ARGENTINA. BALANCE OF PAYMENTS: CURRENT ACCOUNT
(Millions of US Dollars)

	Exports FOB	Imports FOB	Trade Balance FOB	Trade Balance Goods and NFS	Interest Payments	Current Account Balance
1960-64	1206	-1084	122			-153
1965-69	1506	-1091	415		-157	395
1970-74	2530	-2006	524		-308	90
1975-79	5348	-3913	1435	1006	-616	390
1980-84	8145	-6213	1932	891	-4214	-3311
1975	2961	-3510	-549	-814	-430	-1284
1976	3916	-2744	1172	1155	-493	650
1977	5652	-3798	1854	1877	-569	1290
1978	6400	-3489	2911	2466	-681	1833
1979	7810	-6026	1784	348	-907	-537
1980	8021	-9394	-1373	-3259	-1531	-4767
1981	9143	-8391	752	-992	-3700	-4714
1982	7624	-4858	2766	2330	-4719	-2357
1983	7710	-4168	3542	2811	-5408	-2571
1984	8100	-4253	3847	3567	-5712	-2145

Source:
Central Bank of Argentina.

TABLE 7. ARGENTINA. BALANCE OF PAYMENTS: CAPITAL TRANSACTIONS
(Millions of US dollars)

	Current Account Balance (1)	Change in Reserves* (2)	Change in Foreign Debt (3)	Residual** (4)= (1)+(2)+(3)
1975	-1284	723	2571	2010
1976	650	-1154	195	-309
1977	1290	-2090	1398	598
1978	1833	-1966	2818	2685
1979	-537	-4310	6538	1691
1980	-4767	2850	8128	6211
1981	-4714	3569	8509	7364
1982	-2357	706	7963	6312
1983	-2571	-192	2372	-391
1984	-2154	-254	1815	-593
Accumulated				
1975-79	1952	-8797	13520	6675
1980-84	-16563	6679	28787	18903
1975-84	-14581	-2118	42307	25608

* A minus sign indicates an increase in reserves. These are gross foreign assets (including gold) held by the Central Bank.

** Even though the deficit in the current account may be underestimated and the direct foreign investment is not considered, this residual is a good indicator of the accumulation of foreign assets by residents, except the Central Bank.

Source:
Central Bank of Argentina.

TABLE 8. ARGENTINA. FOREIGN DEBT
(Millions of US Dollars)

	GDP in US Dollars							
	Official Exchange Rate	Parity Exchange Rate*	Total Foreign Debt	Gross Reserves	Exports Mechandise	Goods and NFS	Trade Balance	Net Interest Payments
1975	53345	42462	8085	618	2961	3704	-814	430
1976	41574	43966	8280	1772	3916	4752	1155	493
1977	51077	49936	9678	3862	5652	6769	1877	569
1978	65525	52019	12496	5828	6400	7714	2466	681
1979	107975	62392	19034	10138	7810	9601	348	907
1980	153997	71970	27162	7288	8021	10765	-3259	1531
1981	122956	73488	35671	3719	9143	11545	-992	3700
1982	67074	71090	43634	3013	7624	9525	2330	4719
1983	66861	74393	46006	3205	7710	9386	2811	5408
1984	76233	78130	47821	3459	8100	9878	3567	5712

	As % of GDP at Parity Rate				As % of Total Exports			
	Total Debt	Net Debt**	Trade Balance	Interest Payments	Total Debt	Net Debt**	Trade Balance	Interest Payments
1975	19.0	17.6	-1.9	1.0	218.3	201.6	-22.0	11.6
1976	18.8	14.8	2.6	1.1	174.2	137.0	24.3	10.4
1977	19.4	11.6	3.8	1.1	143.0	85.9	27.7	8.4
1978	24.0	12.8	4.7	1.3	162.0	86.4	32.0	8.8
1979	30.5	14.3	0.6	1.5	198.3	92.7	3.6	9.4
1980	37.7	27.6	-4.5	2.1	252.3	184.6	-30.3	14.2
1981	48.5	43.5	-1.3	5.0	309.0	276.8	-8.6	32.0
1982	61.4	57.1	3.3	6.6	458.1	426.5	24.5	49.5
1983	61.8	57.5	3.8	7.3	490.2	456.0	29.9	57.6
1984	61.2	56.8	4.6	7.3	484.1	449.1	36.1	57.8

* Using the parity exchange rate estimated by Carta Economica.

** Total foreign debt minus gross reserves

Source:
Central Bank of Argentina and Carta Economica.

of the public sector was already considered detrimental to economic growth, which motivated the subsequent contraction, while in the 1970s the public sector was increasingly perceived as crowding-out the private sector and as wasting large amounts of resources.

5. Output per capita declined 13.5% between 1979 and 1984 and there is no reason to argue that the 1979 level was exceptionally high. The 1979 level was in line with the declining growth trend and there is no evidence that it was caused by an autonomous expansion in domestic absorption (Table 2). As shown in the tables, there were two major changes between 1975-79 and 1980-84. First, domestic absorption increased sharply with respect to income, as measured by GNP, and this gap was financed with a loss of reserves and an increase in debt. However, domestic absorption increased slightly with respect to output, measured by GDP. Second, as result of the large increase in interest payments to the rest of the world, income declined with respect to output (Table 2). Given the sequence of events and the fact that output increased very little in 1980 and declined substantially in 1981, it can be concluded that initially there was a large expenditure switching from domestic to imported goods and services which fed back the contraction of output via the negative effect of larger interest payments on income. As a result of this process--in addition to the sharp decline in output, income and domestic absorption--the net foreign debt increased 35,466 millions of US dollars (Tables 7 and 8). In the following section I analyze the details of the debt problem.

6. In 1980-84, other economic trends were broke. First, there was a significant change in the composition of domestic absorption. The fall in investment--both in absolute terms and in relation to GDP--has continued up to

1984. This fall has been aggravated by a negative marginal productivity of capital. Second, employment has increased slightly, also with a negative marginal productivity, but not enough to prevent an increase in unemployment (Table 12). Third, the composition of output has finally shifted in favor of agriculture and other primary activites. Fourth, there has been a large increase in the ratio of exports to GDP, mainly as a result of the expansion of exports (Table 5). Fifth, there was a sharp increase in total expenditures of the public sector, from 47.9% of GDP in 1975-79 to 60.6% in 1980-84 as measured in Table 9, to which it has to be added the quasi-fiscal expenditures of the Central Bank. (These expenditures include subsidies to resident debtors in foreign currency, subsidized rediscount lines, and payments of the interest equalization fund or CRM. According to some estimates these expenditures were as high as 20.9% of GDP in 1982 and 10.3% in 1983).

7. The long-run stagnation of Argentina cannot be explained by external factors, as the performance of comparable countries in the last 40 years indicates. The contraction of 1980-84 is said to have been caused by the accumulation of foreign debt and by the increase in international interest rates, which in turn was the result of a significant, exogenous change in world capital markets. However, one has to question the rationality of a policy that implied a large expenditure switching to imported goods and services, without any expansionary effect on domestic output. I think this expenditure switching was an unintended and unforeseen consequence of inconsistent economic policies and the political system failed to react promptly to change these policies.

TABLE 9. ARGENTINA. PUBLIC SECTOR EXPENDITURES AND REVENUES
(as Percent of GDP)

		1961	1965	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
I.	CURRENT REVENUES	33.5	29.3	37.0	31.4	34.5	39.0	43.6	41.2	43.6	45.5	42.2	43.9	44.0
	1. Taxes	20.3	17.8	22.9	16.4	18.6	21.5	24.1	24.1	27.3	26.2	23.0	22.9	25.1
	2. Others	13.2	11.5	14.1	15.1	15.8	17.5	19.5	17.1	16.3	19.3	19.2	21.0	18.9
II.	CURRENT EXPENDITURES	27.6	26.9	30.7	36.7	32.3	30.7	37.4	36.9	41.8	52.9	51.4	51.5	48.6
	1. Salaries	11.3	11.4	11.0	14.8	9.1	8.6	10.6	10.7	12.4	12.6	10.3	13.3	13.3
	2. Goods and Services	7.7	6.0	6.8	9.0	10.5	9.8	10.4	9.6	9.3	10.9	13.3	13.5	12.5
	3. Interest Payments	0.1	0.1	0.8	1.3	2.1	2.1	3.2	3.2	3.6	10.1	12.7	6.4	5.6
	4. Transfers	8.4	9.4	12.2	11.6	10.5	10.2	13.2	13.5	16.5	19.2	15.1	18.3	17.2
III.	SAVINGS (=I-II)	5.9	2.4	6.3	-5.3	2.2	8.3	6.2	4.3	1.8	-7.4	-9.2	-7.6	-4.6
IV.	CAPITAL REVENUES	0.5	0.5	0.5	0.5	0.4	0.8	1.3	0.8	0.8	1.4	1.4	1.2	1.1
V.	CAPITAL OUTLAYS	10.2	5.7	8.8	10.8	13.2	14.1	14.2	11.7	11.2	12.0	10.9	11.4	10.3
VI.	TOTAL REVENUES (=I+IV)	34.0	29.8	37.5	31.9	34.9	39.8	44.9	42.0	44.4	47.0	43.6	45.1	45.1
VII.	TOTAL EXPENDITURES (=II+V)	37.8	32.7	39.5	47.5	45.4	44.8	51.6	48.7	52.9	64.9	62.4	62.9	58.9
VIII.	BALANCE (=VI-VII)	-3.8	-2.9	-2.0	-15.6	-10.6	-5.0	-6.7	-6.7	-8.6	-18.0	-18.8	-17.8	-13.8
FINANCING														
IX.	CENTRAL BANK	0.3	0.7	0.6	8.3	3.5	1.5	0.0	0.0	3.4	5.1	4.8	16.6	6.1
X.	DOMESTIC CREDIT	1.6	-0.2	-0.3	2.7	2.9	1.7	4.0	3.1	1.4	3.8	5.3	-0.3	0.0
XI.	FOREIGN CREDIT	0.4	0.4	0.7	0.2	1.1	1.4	2.2	1.5	1.2	6.8	3.4	0.0	0.1
XII.	OTHER FUNDS	1.5	1.9	1.1	4.4	3.1	0.5	0.5	2.1	2.5	2.3	5.2	1.4	7.6

Source:
Prepared with data from M.A. Broda y Asociados.

TABLE 10. PUBLIC SECTOR EXPENDITURE AND REVENUES, 1984 AND 1985
(as Percent of GDP)

	Central Government		Provinces and Municipalities		Social Security System		Enterprises and Entities		Total Public Sector	
	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985
I. CURRENT REVENUES	12.5	13.8	7.6	8.3	9.4	9.2	14.4	16.7	44.0	48.0
1. Taxes	10.0	11.4	6.3	6.7	8.8	8.7	0.0	0.0	25.1	26.9
2. Others	2.5	2.4	1.3	1.6	0.6	0.5	14.4	16.7	18.9	21.1
II. CURRENT EXPENDITURES	10.7	9.2	9.7	8.4	12.8	12.2	15.4	15.3	48.6	45.1
1. Salaries	3.7	3.0	5.7	4.9	0.4	0.4	3.5	3.0	13.3	11.3
2. Goods and Services	2.0	1.7	1.4	1.4	0.0	0.0	9.1	9.1	12.5	12.2
3. Interest Payments	3.1	2.7	0.1	0.0	0.0	0.0	2.5	2.7	5.6	5.4
4. Transfers	1.9	1.8	2.5	2.0	12.4	11.8	0.4	0.5	17.2	16.2
III. SAVINGS (=I-II)	1.8	4.6	-2.1	-0.1	-3.3	-3.0	-1.0	-1.4	-4.6	2.9
IV. CAPITAL REVENUES	0.0	0.0	0.2	0.1	0.4	0.4	0.5	0.5	1.1	1.0
V. CAPITAL OUTLAYS	1.7	1.6	3.5	3.3	0.2	0.2	4.9	3.9	10.3	9.0
VI. TOTAL REVENUES (=I+IV)	12.5	13.8	7.8	8.4	9.8	9.6	15.0	17.2	45.1	49.0
VII. TOTAL EXPENDITURES (=II+V)	12.4	10.7	13.3	11.7	13.0	12.5	20.3	19.2	58.9	54.1
VIII. BALANCE (=VI-VII)	0.1	3.1	-5.5	-3.3	-3.2	-2.9	-5.3	-2.0	-13.8	-5.1

Note:
The estimates for 1985 are based on the Budget approved in September 1985 and assume a decline of 2.5% in GDP.

Source:
Prepared with data from M.A. Broda y Asociados.

8. The Argentine political system has been ineffective to respond both to unsettling economic conditions and to new opportunities in the world economy. The struggle over power and income has pervaded the policy output of the political system. This output has experienced violent swings as shown, for example, by the frequency and magnitude of changes in relative prices (Table 11) and of changes in different revenues and expenditures of the public sector (Table 9). Furthermore, the few long-term trends in that output have been dysfunctional to efficiency; these trends imply:

(a) the expansion of the public sector as mentioned in paragraph 4;

(b) the politicization of the private sector, mainly as shown by the regulation of prices and wages, by the intervention in labor markets, and by public incentives and guarantees for private investment; and

(c) the closing of the economy, as shown by a bias against exports and heavy protection to domestic producers.

9. The ineffectiveness of the political system can be traced to the crises of participation and of legitimacy that led to the breakdown of constitutional democracy in 1930. The institutional conciliation of mass participation and democratic legitimacy failed then and has proved to be very elusive in the last 55 years. This failure prompted a pervasive struggle over power and income which in turn rendered the political system ineffective. Lack of effectiveness in the management of the economy undermined successive governments, feeding back the crisis of legitimacy and exacerbating the struggle over power and income.

10. After 1970, as a result of the economic and political failure of the Ongania Government, the disruption of the political system took new force and direction. The new force, as shown by the passive acceptance of violence as

part of political confrontation, resulted from defiance to the power of the military, which could not longer oppose the participation of the Peronist party. The new direction resulted from unbounded, non-responsible authority as the form of government attempted first by the Peronist party and later on by the military. These political developments had a major impact on the economy, causing the crisis of 1980-84.

II. THE ACCUMULATION AND SERVICE OF FOREIGN DEBT

11. By 1975, foreign debt was not a burden, even though its level in relation to exports was high (Table 8). Since then, three periods can be identified in the development of the Argentine debt problem:

(a) up to 1979, there was a significant increase in the dollar amount of foreign debt, but it declined with respect to exports, and most of the increase was paralleled by accumulation of reserves by the Central Bank; furthermore, in this period there was a superavit in the current account;

(b) between 1980 and 1982, the debt increased sharply both in dollar amount and in relation to GDP and exports, and at the same time there was a large loss of reserves; in this period there was a huge deficit in the current account; and

(c) since 1982, the foreign debt has continued increasing in dollar amount but not with respect to GDP and exports; the Central Bank has been able to stop the loss of reserves and the deficit in the current account has been reduced.

TABLE 11. ARGENTINA. RELATIVE PRICES AND REAL WAGES
(1970=100)

	Real Exchange Rate (1)	Agricultural Prices (2)	Import Prices (3)	Real Wages (4)
1970	100.00	100.00	100.00	100.00
1971	88.50	108.43	90.03	100.65
1972	102.22	126.33	108.05	95.60
1973	75.67	88.77	98.28	100.08
1974	69.84	104.26	126.76	110.50
1975	78.72	82.74	146.82	106.43
1976	107.16	91.52	203.87	76.63
1977	98.47	97.69	186.76	70.85
1978	80.07	91.98	128.03	69.30
1979	59.52	90.98	97.47	78.48
1980	47.20	82.20	94.26	88.45
1981	59.86	75.11	114.46	80.68
1982	105.55	88.27	163.12	69.98
1983	111.26	91.09	154.92	87.98
1984	102.48			110.38
Average	85.77	94.24	129.49	89.73
S.D.	19.50	12.30	35.10	14.26

Notes:
(1) Estimated by Carta Economica using the GDP deflator for Argentina and the WPI for USA.
(2) Agricultural prices relative to non-agricultural domestic prices according to WPI.
(3) Import prices relative to non-agricultural domestic prices according to WPI.
(4) Estimated by Carta Economica using the series of nominal wages from IOL-Ministry of Labor.

Source:
INDEC and Carta Economica.

TABLE 12. ARGENTINA. EMPLOYMENT IN LARGE URBAN AREAS*

	Labor Force Participation %	Employment % Population	Employment 1970 =100	Unemployment Rate %	Employment in Services %
1966	44.9	42.6	92.8	5.1	55.3
1970	43.9	41.7	100.0	5.1	56.6
1974	39.3	38.1	111.4	3.0	49.7
1975	40.0	38.6	116.6	3.5	49.6
1976	38.9	37.2	110.5	4.3	51.5
1977	38.8	37.8	115.0	2.5	52.9
1978	39.5	38.7	113.5	2.0	53.3
1979	39.2	38.4	109.3	2.2	54.4
1980	39.2	38.2	117.7	2.4	53.3
1981	39.0	36.9	121.3	5.3	56.8
1982	39.2	37.5	123.2	4.3	61.3
1983	38.0	36.6	122.5	3.8	60.7
1984	38.6	36.6	124.9	5.3	59.5

*Greater Buenos Aires, Greater Cordoba, Greater Rosario, Mendoza and Tucuman.

Source:
INDEC.

TABLE 13. ARGENTINA. MARGINAL PRODUCTIVITY OF CAPITAL
(Five Year Averages)

	Investment in Fixed Capital as % GDP		Change in GDP per Unit of Investment	
	Gross	Net	Gross	Net
1950-54	15.9	5.1	0.13	0.41
1955-59	16.1	6.4	0.18	0.46
1960-64	19.9	10.3	0.21	0.41
1965-69	18.9	9.3	0.27	0.54
1970-74	20.8	11.0	0.12	0.23
1975-79	21.7	11.9	0.08	0.15
1980-84	17.0	6.8	-0.07	-0.16

Source:
M.A. Broda and J.C. de Pablo « Por los Carriles Tradicionales la Argentina Esta Condenada al Estancamiento Absoluto por Muchos Anos. Pero Hay Salidas », Serie Seminarios, Instituto Torcuato Di Tella, November 1985.

TABLE 14. ARGENTINA. MONETARY AGGREGATES AND INTEREST RATES

	M1	M2	M3	M4	Real Interest Rates % Annual Deposits	Real Interest Rates % Annual Loans
	as percent of GDP					
1950-54	25.23	33.53	33.53	33.53		
1955-59	21.26	28.13	28.13	28.13		
1960-64	13.99	18.96	18.96	18.96		
1965-69	12.74	19.91	19.91	19.91		
1970-74	12.83	22.83	24.14	24.18		
1975-79	7.29	16.65	17.48	19.89		
1980-84	4.88	17.38	17.49	20.04		
1975	10.13	16.30	17.98	19.05	-72.36	-68.57
1976	7.27	10.50	11.75	14.63	-65.14	-65.04
1977	6.79	15.24	16.32	19.30	-19.78	-0.66
1978	6.32	20.05	20.14	22.81	-14.61	11.92
1979	5.94	21.17	21.20	23.66	-9.43	2.58
1980	6.43	24.53	24.56	26.71	-4.38	25.91
1981	5.17	22.57	22.58	25.52	9.51	7.03
1982	5.03	19.31	19.31	22.34	-15.13	-12.42
1983	4.02	11.34	11.35	13.75	-9.56	-18.44
1984	3.74	9.16	9.67	11.90		

Notes:

M1 = Currency + demand deposits.
M2 = M1 + Savings and time deposits.
M3 = M2 + non-regulated deposits + acceptances.
M4 = M3 + Treasury's Indexed Bonds (VNA) + Treasury's Bills + Mortgage Bonds + Indexed Long-Term Deposits + Dollar Deposits.

Sources:

Prepared with data from M.A. Broda y Asociados. Interest rates from World Bank « Argentina Economic Memorandum », 1985, p. 205.

12. In 1976-79, economic policy was aimed at correcting the imbalances inherited from the Peronist Government (May 1973-March 1976). After the initial measures to correct the external imbalance, the stabilization program was based on:

(a) a reduction in the deficit of the public sector, with the remaining deficit being financed by domestic and foreign credit, but not by the issue of money;

(b) a restrictive monetary policy, which implied that monetary expansion to meet the demand for high-powered money was to come from the accumulation of reserves; and

(c) expectations management, which relied upon direct and indirect price controls (wage freeze, tariff reductions, price truces, voluntary agreements, and finally, after the others failed, the preannouncement of the exchange rate).

All the three components of the stabilization program were unsustainable:

(a) the deficit of the public sector continued being very high to be financed with debt because interest payments would have created an explosive path;

(b) the inflation rate continued being very high (Table 1) and so did the flow demand for high-powered money to keep real balances constant; the attempt to meet this demand by accumulating reserves, which in turn called for a superavit in the current account and/or a large inflow of foreign credit, implied a heavy burden for the private sector; and

(c) expectations management just amounted to repress inflation by controlling some prices, which created sectoral and income imbalances that sooner or later would have to be corrected (so-called "sinceramiento" of prices).

13. The collapse of that stabilization program, which started in early 1980, was followed by a period of great economic and political unrest. The program failed initially because of an autonomous expansion in the deficit of the public sector and of the financial crisis of March 1980, but the increasing perception of the incoherence of the program was decisive to give rise to the large expenditure switching mentioned in paragraphs 5 and 7. The collapse was aggravated by interest payments on the public debt and capital flight, and later on by a decline in the revenues of the public sector. The economic mismanagement of this period has some parallel with that of other periods in which a stabilization program collapsed (1974-76, 1970-72, 1962); the main difference is the legacy of a huge foreign debt.

14. By the end of 1982, the Argentine Government initiated negotiations with the IMF and with foreign bank creditors to obtain additional funds and to reschedule the debt. The Bignone Government reached an agreement with the IMF which became effective in early 1983 and the Alfonsin Government reached a new agreement with the IMF at the end of 1984. Access to resources under both agreements was quickly interrupted, mainly because the Argentine Government could not remain within the limits set for the major macroeconomic targets of the programs. Both programs were based on a gradual reduction of the deficit of the public sector; other measures were largely determined by the specific circumstances of each situation. In 1983, revenues did not increase as anticipated in the program which, together with the persistence of external payments arrears, prompted a breakdown in the agreement. In the second program, expenditures were significantly cut (Table 9) but with a minor impact

on inflation, which prompted the Government to abandon it. In August 1985, after the Austral Plan was implemented, there have been a new agreements with both the IMF and bank creditors (see paragraph 32).

15. By the end of 1983, the total foreign debt of Argentina amounted to 46,005 millions of US dollars, of which 32,200 millions (70%) were due to commercial banks, 5,000 millions to suppliers and other private sources, 4,200 millions to bond holders (other than Bonds and Promissory Notes that are included in the debt with commercial banks), and the remaining 10% was due to bilateral and multilateral institutions, including the IMF. It is estimated that by the end of 1985 the total foreign debt will amount to 50,239 millions of US dollars, which would imply an increase in the ratio to GDP up to 0.64, in comparison with 0.61 in 1984 (Table 8). The debt burden is quite heavy, even though relief has been important. At prices of 1970, according to the national accounts (Table 5), the effective transfer as measured by the trade balance amounted to 5.7% GDP in 1983 and to 5.1% in 1984, and to 39.1% and 36.6% of exports respectively. In 1985, at 1970 prices, this transfer may increase up to 6% of GDP and up to 40% of exports, because the expansion in the volume of exports will be largely compensated by a deterioration in the terms of trade. At current prices, as shown in Table 8, the effective transfer amounted to 3.8% of GDP in 1983 and to 4.6% in 1984; in 1985 the transfer will be around 4.5% of GDP. Debt relief, measured by the difference between interest payments and the trade balance, was 3.5% of GDP in 1983 and 2.7% in 1984 (Table 8).

III. INFLATION AND THE STABILIZATION PROGRAM OF JUNE 1985

16. Inflation started around 1945, and since then two main periods can be distinguished (Table 1). Up to 1970 inflation was high in relation to other

countries, but the average rate of inflation was not very high at 24% per year. A major problem was the great variability of inflation -- there were a couple of years in which inflation was as low as 3-4% and a year in which it was as high as 113.7% -- which reflected successive periods of acceleration and of stabilization. Since 1971 inflation has been accelerating, up to 60.3% in 1973, to 444.1% in 1976, and to around 800.0% in 1985, which are the years in which major stabilization programs were implemented. Of course, in this second period the variability of inflation has been much larger than in the previous one: the short-run success of the Peronist program implied an inflation of only 24.2% in 1974, and that of Martinez de Hoz's program an inflation of 100.8% in 1980.

17. One of the two major causes of inflation is the deficit of the public sector. In paragraph 4, I have already referred to the expansion of this sector, broadly defined as in Tables 9 and 10. Since 1970, current revenues of the public sector have been increasing, but not pari-passu with expenditures. Furthermore, they have shown large swings around that increasing long-run trend, another indicator of the pervasive struggle over power and income as well as of the erosion of the tax base when inflation has been accelerating. The deficit of the public sector averaged only 3.6% of GDP in the ten years 1961-70 and increased up to 8.7% of GDP in 1971-75. Initially this increase was financed by the printing of money and later on, in 1977-79 when the deficit declined to 6.1% of GDP, by domestic and foreign debt. In 1980-84, the deficit has averaged 15.4% of GDP without taking into account the cuasi-fiscal expenditures of the Central Bank, and half of it has been financed by printing money.

18. The second cause of inflation has been the already mentioned struggle over income shares, which has significantly affected the short-run behavior of taxes and relative prices. Monetary policy has frequently accommodated changes in relative prices resulting from increases in nominal prices. Increases in nominal wages, in the nominal exchange rate, in the nominal prices of petroleum and agricultural commodities, have largely been determined by political forces. Regardless violent swings, domestic relative prices have not shown well defined trends, even though it can be concluded that in the last 15 years imports have become more expensive (Table 11).

19. Political adjustments in nominal and relative prices have been complemented by formal and informal indexation. However, indexation has not been as pervasive as in Chile, where a unit of account linked to the consumer price index has been extensively used. Inflation-adjustment clauses have been common in long-term contracts, while the nominal interest rates of financial contracts have usually included some expectation of inflation. Government attempts to index the exchange rate and nominal wages have been very limited. The great variability of inflation has been closely associated to the violent swings in relative prices, which has limited the value of indexation.

20. Major stabilization programs were implemented in 1967-69, 1973-74 and 1976-79. As mentioned these programs had some temporary success in reducing the rate of inflation, but they collapsed and inflation quickly accelerated. These programs reduced initially the deficit of the public sector and attempted to control monetary expansion, but they were aimed at "managing" inflationary expectations by direct or indirect control of some prices, and thus after a new structure of relative prices was set. In the 1967-69 program

the initial devaluation was followed by a fixed exchange rate, a wage freeze and a price voluntary agreement. In the 1973-74 program the initial increase in nominal wages was followed by a general freeze of prices and wages. In both cases, neither the new structure of relative prices nor the reduction in the deficit of the public sector were sustainable. In paragraph 12, I have referred to the 1976-79 program.

21. In the first 18 months of government President Alfonsin failed to implement a consistent stabilization program, even though the short-lived agreement with the IMF at the end of 1984 revealed the intention of sacrifycing the gains in real wages granted in the previous months (Tables 11 and 15). These gains contributed to the acceleration of inflation during 1984, from 18% per month in the last quarter of 1983 to 23% per month in the third quarter of 1984. The breakdown of the IMF agreement implied a new acceleration of inflation, up to 27% per month in the quarter from March to May 1985. In the meantime, output was declining after the small recovery of 1983-84. In the first quarter of 1985 GDP declined 1.4% with respect to the same period in 1984, and in the second quarter it declined 3.4% with respect to the second quarter of 1984. It was in this context that the Argentine Government decided to undertake a new major stabilization program. Some measures were implemented at the end of May and others in early June, but the core of the program was announced June 14th. The program is known as Plan Austral because of the new unit of money.

22. The Plan Austral is based upon:

(a) A reduction in the deficit of the public sector and a commitment not to finance the remaining deficit by printing money.

(b) An initial realignment of relative prices and the subsequent freeze of the new structure of relative prices.

(c) An attempt to break inflationary expectations by (a) as well as by a general freeze of nominal wages and prices, including a fixed exchange rate.

(d) A mechanism to adjust outstanding financial contracts to avoid the distributive effect of the immediate and unanticipated cessation of inflation.

23. The measures to reduce the deficit of the public sector included new taxes and an increase in the prices of public utilities and of goods produced by State enterprises as well as a non-discriminatory reduction in wages and capital expenditures. New taxes included an increase in export and import taxes and a forced saving tax. In addition, the average lag in the payment of the value added tax was reduced so the Government will collect 13 months of this tax in 1985. Tax revenues were also expected to increase as a result of the recovery in the base, which was eroded by the acceleration of inflation. As shown in Table 15 increases in the prices of petroleum and other goods produced by State enterprises have been significant, but the increases have been much larger when taxes are included. The increase in revenue since the Plan was implemented has been extraordinary (Table 15). Annual figures on expenditures and revenues as percent of GDP are presented in Table 10. The deficit is expected to decline up to 5.1% of GDP for all 1985, even though in the first semester of 1985 it was around 12.5% of GDP.

24. The Government has committed itself not to finance the remaining deficit by printing money and so far has complied. Before the announcement of the program there was a large monetary expansion to finance the deficit in the

TABLE 15. ARGENTINA: ECONOMIC INDICATORS

	Unit	Year 1983	Year 1984	1984 Dic.	1985 Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.
NATIONAL ACCOUNTS													
GDP, total	1970=100	116.4	119.2			114.0			114.3				
GDP, agriculture	1970=100	136.3	141.3			139.5			136.8				
GDP, manufacture	1970=100	113.3	117.8			99.0			107.7				
Consumption	1970=100	122.4	130.2			127.4			117.4				
Investment	1970=100	81.4	70.5			57.6			62.7				
Industrial production	1970=100	104.1	108.6	100.9	101.4	97.3	104.7	100.2	101.5	94.4	91.7	94.4	
PRICES													
Wholesale prices	% change period	360.9	573.3	23.2	21.1	17.8	27.7	31.5	31.2	42.3	-0.9	1.5	0.6
Consumer prices	% change period	343.8	626.7	19.7	25.1	20.7	26.5	29.5	25.1	30.5	6.2	3.1	2.0
REAL WAGES													
Manufacture	1982=100	124.7	150.4	152.1	143.5	133.7	132.3	132.1	134.9	128.1	120.6	111.5	109.3
Construction	1982=100	146.0	178.5	159.3	139.7	133.0	132.3	127.0	128.6	120.8	113.7	110.7	108.5
Public sector	1982=100	94.9	106.6	96.8	93.4	88.7	85.1	81.4	82.3	77.3	77.8	70.6	69.2
EXCHANGE RATE													
Official exchange rate	% change period	377.3	545.7	20.5	25.1	20.6	26.3	29.4	32.4	40.2	8.8	0.0	0.0
Spread Parallel/official	%	40.6	31.3	13.1	19.3	30.8	31.6	29.6	18.1	9.2	18.6	19.3	17.4
Spread official/parity	%	11.3	2.5	10.0	13.2	14.8	13.2	12.9	13.8	16.9	25.7	23.0	21.0
TRADE													
Exports	Millions US$	7836	8102	476	626	531	647	829	806	934	830	740	
Imports	Millions US$	4504	4581	424	373	265	335	342	333	249	350	320	
Trade balance	Millions US$	3332	3521	62	353	266	312	487	473	685	480	420	
PUBLIC SECTOR													
Revenues, real	Thousands A$1982	9265	9520	734	696	442	638	800	669	1331	1514	1477	
Expenditures, real	Thousands A$1982	22418	17412	1506	1263	1450	1312	2020	1623	1770	1566	1497	1451
Revenues/expenditures	%	41.3	48.9	55.5	58.1	48.0	33.7	31.6	49.3	27.4	85.0	101.1	101.8
Real Prices													
Of State Products	1982=100	109.2	127.5	136.6	136.0	131.4	128.6	124.8	135.2	146.9	154.3	150.7	148.9
Of Petroleum	1982=100	121.5	152.5	160.9	160.8	155.1	151.7	145.1	158.4	171.5	180.0	175.8	173.7
MONEY AND INTEREST													
Monetary base, average	Millions A$	87	489	935	1142	1292	1391	1478	1356	1952	2795	3071	3286
Monetary base, average, real	1982=100	112.0	86.4	72.2	72.5	69.1	58.7	48.2	40.3	41.3	60.0	64.4	68.1
M2, average	Millions A$	84	505	1048	1276	1506	1781	2091	2605	3759	4817	4931	5190
M2, average, real	1982=100	75.1	62.8	58.8	58.8	58.0	53.4	59.2	57.1	60.3	75.9	78.9	
Loan interest rates													
regulated	% per month	12.6	15.6	19.0	20.0	20.0	22.0	28.0	32.0	17.2	5.0	5.0	
Free	% per month	18.7	18.8	33.2	25.2	22.9	25.5	27.4	31.1	18.8	7.2	5.5	

Source:
Carta Economica.

TABLE 16. SOURCES OF EXPANSION AND CONTRACTION OF THE MONETARY BASE
(Monthly Flows, in Millions of A$)

	June	July	August	September	October
1. External Sector	549	427	310	4	
2. External Financing To Government	-168	71	0	-7	
3. Government Sector	303	11	0	1	
4. Financial System	660	-85	720	282	
5. Deposits in Special Accounts	-394	-39	-715	-217	
6. Interest Equalization Fund (CRM)	266	93	143	147	
7. Others	-42	46	-37	-46	
Monetary Base	1,172	522	423	165	
Currency	491	409	90	82	
Deposits	681	112	333	83	

Source:
Carta Economica.

second half of June; in early June the Central Bank deposited the equivalent to 25% of the monetary base as of May 31, in the Treasury account at Banco de la Nacion. Since then the Government has been able to finance the remaining deficit with foreign credit. However, there has been some issue of money to finance the cuasi-fiscal expenditures of the Central Bank (Table 16).

25. The Plan included a change in currency but there was no commitment with respect to monetary policy, except for the non-financing of the deficit of the public sector. The monetary base has increased as a result of both the accumulation of reserves and of domestic credit (Table 16). By September the monetary base, in real terms, had increased around 60% with respect to June, but it still was about 20% lower than the average of 1984 (Table 15). Because of the high, ex-post real interest rates since the Plan was implemented, there has been some discussion about how restrictive the monetary policy should be. The Government has been very reluctant to expand the monetary base to meet an uncertain increase in the demand for it. In fact, the possibility of low and stable real interest rates continues depending upon a sharp break in inflationary expectations and upon a larger portfolio shift than the one that took place in June and July.

26. A significant realignment in relative prices took place just before June 14th. First, there was a devaluation of 15% over the preset value for June 11th, but this devaluation was largely compensated by export taxes. Second, prices of imports were also affected by an increase of 10 percent points in the tariff. Third, as mentioned, the prices of petroleum and other goods produced by State enterprises were adjusted before June 14th. Fourth, the adjustment in nominal wages was to partly compensate for the inflation between the previous adjustment and June 14th. The impact of these changes

can be observed in Table 15: in July the official exchange rate was 10.5% over the May value of the parity rate (25.7% over the 1970 value of this rate); the prices set by State enterprises increased 14% in real value between May and July; and real wages in manufacturing declined 10.5% between those two months.

27. The realignment of relative prices was followed by a general freeze of wages and prices. The exchange rate has been fixed at 0.801 australes per dollar and the prices of petroleum and of other goods produced by State enterprises have also been maintained at their new nominal values. Nominal wages have remained constant, but there is evidence of some adjustment in the private sector via salary advances and other mechanisms. The freeze has been successful in reducing inflation from 27% per month in March-May to 2.3% per month in August-October.

28. The great innovation of the Austral Plan was the depreciation of the old money in terms of australes according to a preannounced daily schedule. This "tablita" was to be applied to outstanding financial contracts in which the nominal interest rate included an expected inflation, otherwise the immediate and unanticipated cessation of inflation would have implied a large redistribution of income from debtors to creditors. This redistribution would have in turn threatened the general freeze of prices. The "tablita" was a temporary mechanism and it has already lost any significance.

29. The immediate internal reaction to the Plan Austral was very favorable, reflecting a consensus about the critical situation that the country was facing. That reaction implied a portfolio shift -- a substitution of domestic monetary assets for foreign currency and assets -- and a low cost to enforce the price freeze. After July, that portfolio shift was not enough

to quickly reduce real interest rates (Table 16). More recently, the enforcement of the price freeze has become more difficult. By now inflationary expectations are very mixed and it is not clear to what extent the high nominal interest rates are due to persistence of these expectations. The results of the recent congressional elections (November 3) do not indicate any strong position either in favor or against the Plan Austral.

30. Given the previous experience with stabilization programs, the possibility of a collapse cannot be ignored. Even if the Argentine Government did not reverse its fiscal policy, the program could collapse because:

(a) the freeze of wages and prices will become repressed inflation if there is monetary expansion to finance the cuasi-fiscal expenditures of the Central Bank;

(b) there is an urgent need for flexibility in the structure of relative prices to accommodate real shocks, like the recent deterioration in the terms of trade (the prices of the main grain exports have declined around 25 percent between the 1984 average and the third quarter of 1985).

(c) real interest rates are too high, at least ex-post, and may create expectations that the Government will bail-out debtors; and

(d) the new structure of relative prices -- in particular, real wages -- has not been politically validated yet.

31. Another critical issue is the possibility of a reversal in fiscal policy that may again imply a large deficit. The concern refers both to revenues and to expenditures. The increase in revenues derived from export and import taxes is substantial and therefore it is difficult to substitute

new taxes for them. The level of export taxes was high even before the Plan. In addition, the prices of petroleum and goods produced by State enterprises may be appropriate to finance these enterprises, but they seem to be too high to be politically sustainable and in some cases they may even be too high vis a vis international prices. With respect to expenditures, the Government has attempted to minimize the contraction by emphasizing that the Plan intended to substitute other taxes for the inflation tax. However, there has been a reduction in wages and in the benefits of the social security system that may be unsustainable. The decline in the real value of wages and of those benefits has been too large vis a vis the decline in the incomes of other groups. Finally, the level of public investment will be very low in 1985 as a result of a general cut in programs, but not of applying economic criteria.

32. In August the Argentine Government reached a new agreement with the IMF and subsequently with bank creditors. This agreement implied a break in the strategy followed by both the Argentine Government and the IMF. The new program was largely designed by the Government, with targets consistent with the Austral Plan and more severe than targets set in the short-lived agreement of early June. The targets set for September were met and the probability of satisfying the targets set for March 1986, is high. In addition, the IMF endorsed the general freeze on wages and prices implemented by the Argentine Government, even though it was contrary to recommendations usually made by the IMF. The agreement with the IMF and the subsequent one with bank creditors allowed the Argentine Government to eliminate foreign payments arrears and to pay all remaining bridge loans. The agreements also rescheduled the foreign debt and provided additional funds until July 1987. I do not have all the information to appraise the burden of debt after the agreements.

33. Since the end of 1982, Argentina had been attempting to implement some stabilization program, but only last June the Government finally abandoned gradualism. The social costs of gradualism compounded the costs of economic mismanagement in 1980-82 without any significant, durable gain over inflation. The loss of income has been very serious for some sectors, like government employees and the beneficiaries of the social security system. Unemployment has increased, even though the regulatory system has prevented a much larger increase in open unemployment. Furthermore, the public sector has lacked the capacity to provide relief to the poor. The new stabilization program is likely to impose an additional burden to those that have suffered more in the last five years (public employees, beneficiaries of the social security system and the unemployed), while other low income groups may partly compensate their loss of factor income with the elimination of the inflation tax.

IV. CONCLUSIONS

34. Three major constraints on growth were identified in the previous sections:

(a) the unsettled political system, which has continuously failed to provide effective responses to changing economic conditions and which has become a major source of economic inefficiency;

(b) the heavy debt burden inherited from economic mismanagement in 1980-82; and

(c) the inflationary pressures derived from the expansion of the public sector and from the struggle over income shares.

35. Those constraints have resulted in a low investment ratio and in a very low marginal productivity of capital, and consequently in the prospect of stagnation or even decline. Numerical exercises based on extrapolating recent levels of investment and productivity are conclusive (see Appendix B). Additional debt relief may facilitate an increase in investment, but given the large holdings of foreign assets by Argentinians it can be argued that additional debt relief is neither sufficient nor necessary for growth. Only the settlement of the political system may create the incentives both for repatriation of that capital and for a substantial recovery in productivity.

36. Immediately, the Argentine political system faces the challenge of consolidating stabilization. Very strong fiscal and monetary commitments and some truce over income shares are called for getting rid of the general freeze of wages and prices without a revival of inflation. The strength of those commitments and the viability of that truce will depend largely upon the political compromise that the Government is able to achieve with other parties, and first within its own party. Success in getting this compromise will be an indicator that Argentina is starting to settle her political system. In Appendix A, I analyze some details of this second stage of the Austral Plan.

37. The burden of debt is already very heavy and additional foreign credits would increase this burden without contributing to settle the political system. Which is the probability that those funds will be used to finance investment rather than consumption? Which is the probability that, if the funds are invested, productivity will be positive? Will a politicized private sector and an inefficient public sector behave differently? These

questions have to be answered by reference to Argentine history, at least until there is strong evidence of a significant change in the political system.

38. Debt relief is badly needed just to maintain the 1985 level of domestic expenditure and output, and if the terms of trade do not improve in 1986 that relief will have to increase with respect to its level of 1983-85 (around 3% of GDP). This relief, which is increasing the burden of debt without enhancing the prospect of growth, should continue being conditional upon a strong commitment to stabilization. Only if stabilization succeeded, what would be indicating some progress in the settlement of the political system, additional foreign credits would be needed to support the growth of the private sector.

APPENDIX A

SECOND STAGE OF THE "PLAN AUSTRAL"

As discussed in the text the success of the current stabilization program is critical for economic growth. The results of the program in the first five months have been satisfactory, but endurable stabilization calls for institutional and policy reforms that will take some time to be designed and implemented. For those results to become permanent, the Argentine Government will have to commit itself to build a strong political support for the reforms. The next four months will be critical to build this support and therefore to secure the success of the Plan.

The second stage of the Austral Plan should aim at securing:

(a) a sharp break in inflationary expectations on the basis of strong commitments to fiscal and monetary discipline in the short and in the long-run; and

(b) an increasing degree of flexibility in relative prices and wages.

With respect to (a), it should be noted that the commitments of the first stage were limited to 1985 (even though the agreement with the IMF is up to March 1986) and that they were not enough to completely break inflationary expectations. With respect to (b), the first stage of the Plan is based on a general freeze of prices and wages that cannot be maintained indefinitely:

there is already the need of getting rid of it to avoid later on a sharp brake in prices that would create a new inflationary process (as has happened with previous stabilization programs).

The objectives of the second stage call for:

(a) fiscal commitments on the 1986 budget and on guidelines for a large reform of the public sector in the next, say, three years;

(b) monetary commitments on the issue of high-powered money and on exchange rate management in 1986, as well as on guidelines for the reform of the Central Bank after 1986; and

(c) an agreement on nominal wages for 1986 and a commitment on guidelines to reform the collective bargaining process.

Commitments on guidelines for reforms that will have effects in the medium and long-run are as much important as the specific policies for 1986. Credibility in commitments and in policies will depend upon the political support that the government is able to build and in some cases upon the mechanisms to monitor government's compliance. The general freeze of prices should be abandoned simultaneously with the announcements of these commitments and policies.

Fiscal, monetary and wage policies and institutions should be considered in the design of the second stage of the stabilization program. The main issues in each of these areas are identified below.

1. Fiscal Policy and Institutions

For 1986, the key issue is how to implement some changes in revenues and expenditures, (a) without increasing total expenditures as a percent of GDP and (b) while keeping the deficit of the public sector at the low level of the second half of 1985. It is very difficult to identify those changes, but one cannot ignore that in 1985, some critical problems may have developed within the public sector that demand adjustments in either revenues or expenditures.

With respect to commitments for reforms, the analysis should distinguish between government (including provinces and municipalities), the social security system and state enterprises. The key issues are:

(a) How to limit the size of government (at least in the sense of freezing its current size)?;

(b) How to reallocate resources within government? Any freeze of the size of government should be accompanied by a significant reallocation of resources among activities;

(c) How to reform the tax system, to avoid taxation of foreign trade because of expediency and to minimize evasion?;

(d) How to finance sustainable real values of social security benefits?;

(e) How to secure efficiency in state enterprises? (Is privatization the only alternative?); and

(f) How to limit the expansion of state enterprises?

2. Monetary Policy and Institutions

For 1986 the Government will have to choose between (a) limiting the expansion of high-powered money to a preannounced amount and let the exchange rate float, and (b) committing to expand high-powered money only at the same rate as the accumulation of reserves while maintaining a fixed exchange rate. This is a very difficult decision, but to break inflationary expectations it is necessary to persuade the public that the monetary regime has definitely changed.

To support that perception, Central Bank reforms must be undertaken and in 1986 the Government should provide guidelines for this reform. Given the large monetary power granted to the Central Bank, reform can only mean less power. The possibility of reducing the Central Bank to an Exchange Board, as before its creation in 1935, will have to be considered.

3. Wage Policy and Institutions

In 1986, some increase in nominal wages will have to be granted and the problem is how to negotiate an agreement with labor unions to minimize the amount of that increase. In addition, it is important to give clear signals that wages will no longer be set by government. As part of this the Government will have to provide some guidelines for the reform of the collective bargaining law as soon as politically possible.

Appendix B

Output and Debt in Different Scenarios

In a recent paper, M.A. Broda and J.C. de Pablo ("Por los Carriles Tradicionales, la Argentina esta Condenada al Estancamiento Absoluto por Muchos Anos. Pero Hay Salidas," Seminarios Internos, Instituto Di Tella, November 1985) have projected the path of output, consumption and debt in different scenarios. Their main results are summarized in Table B-1. Two assumptions are common to the three scenarios. First, the effective transfer to the rest of the world, measured by the trade balance, is always 5.7% of GDP at prices of 1970 (see Table 5 and paragraph 15 in the text). Second, consumption is extrapolated from 1950-82 according to a regression on GDP, but it is adjusted to take into account some arbitrary, minimum level.

Differences between the scenarios are indicated in the upper part of Table B-1 and refer to additional external funds and to the value of the marginal productivity of capital. In scenario C it is assumed that additional funds in the form of direct foreign investment, so foreign debt does not increase, are entirely allocated to investment in fixed capital. In scenario A it is assumed that the marginal productivity of capital is equal to the 1951-84 average, but the declining trend over this period should be noted (see Table 13). In scenarios B and C it is assumed that this productivity increases 100 percent with respect to the 1951-84 average.

The projections of output are derived directly from the assumed increase in the stock of capital and from the assumed value of the marginal productivity. The projections of consumption are obtained from a simple regression for 1950-82, taking into account some minimum level. Finally, the projections of foreign debt result from the difference between contractual interest payments and the current dollar value of the effective transfer. This difference varies with the interest rate applied to project those payments and with the terms of trade used to calculate the current dollar value of the trade balance.

From the results of Table B-1 it can be concluded that either an increase of 100 percent in the marginal productivity of capital with respect to the 1951-84 average, or a large increase in investment (around 3% of GDP) are required to secure a low rate of output growth of around 3% per year (1.4% in output per capita). This growth rate would be similar to the 1900-80 rate (see Table 1). However, both conditions represent major challenges. The marginal productivity of capital has been declining in the last 35 years and an increase in investment of around 3% of GDP will call for a significant change in prospects, so either a repatriation of capital or direct foreign investment finance that increase. For a substantial increase in the growth rate of output, an extraordinary increase in investment will be required in addition to some increase in the marginal productivity of capital (scenario C in Table B-1).

In the lower part of Table B-1 some projections of total foreign debt are included. For each scenario there are three cases, so the implications of different interest rates and of different terms of trade can be assessed. The rate of 11.1% per year is the implicit interest paid by

Argentina in 1984 and "no change" in the terms of trade implies that the value of 1984 is maintained over the next ten years. In other projections it is assumed that the interest rate declined from 11.1% to 10% in 1986, 9% in 1987, and 8% in 1988 and the following years. Also, in other projections it is assumed that the terms of trade deteriorate at the rate of 4% per year, which means that import prices increase at 4% and export prices remain constant in nominal value.

The projections of foreign debt in Table B-1 are at current prices and even in the worst case (that is, case 4 in scenario A) debt in relation to GDP would decline from 0.64 in 1985 to 0.55 in 1994. However, only if interest rates declined to 8% and the terms of trade remained in their 1984 value (case 1), the nominal value of total debt would decline in all the three scenarios. In case 1, the effective transfer would increase at a rate equal to the growth rate of total output compounded by the increase in nominal prices (4% per year) and so eventually would be larger than interest payments, which in turn would decline as a result of a lower interest rate. It should be noted that the terms of trade deteriorated in 1985, an estimated 8% with respect to 1984, and that the implicit interest rate has been around 11%.

TABLE B1 - ARGENTINA. PROJECTIONS OF OUTPUT AND DEBT
IN DIFFERENT SCENARIOS

	UNIT	A	B	C
ASSUMPTIONS				
Direct Foreign Investment	Millions US$	0	0	5,000
MarginalProductivity of Capital	Per A$	0.1219	0.2438	0.2438
RESULTS (Annual Average)				
Output, Total	% Change	1.00	3.07	8.20
Per Capita	% Change	-0.65	1.40	6.44
Consumption, Total	% Change	1.03	2.30	7.16
Per Capita	% Change	-0.62	0.63	5.42
TOTAL FOREIGN DEBT				
1985	Millions US$	50,239	50,239	50,239
Case 1: IR=8.0%; TT= No Change				
1990		52,765	51,980	48,323
1994		48,172	43,885	26,918
Case 2: IR=8.0%; TT= -4%				
1990		54,447	53,751	50,502
1994		55,412	52,000	38,375
Case 3: IR=11.1%; TT= No Change				
1990		57,902	57,109	53,414
1994		62,520	58,077	40,405
Case 4: IR=11.1%; TT= -4%				
1990		59,603	58,900	55,615
1994		70,081	66,533	52,293

Source:
M.A. Broda and J.C. de Palbo « Por los Carriles Tradicionales la Argentina Esta Condenada al Estancamiento Absoluto por Muchos Anos. Pero Hay Salidas », Serie Seminarios, Instituto Torcuato Di Tella, November 1985.

Argentina.

1. Policy reforms much too general & vague.
2. No specification of timing and phasing of an economic adjustment package.
3. No discussion of how the Bank will monitor such a package.
4. No discussion of Bank-Fund (Who will do what).
5. External K requirements? Source?
6. COSW?

- Imp. to make a clean-cut distinction b/ stabilizat^n pol + policy for growth Must focus on latter for 5 year SA Prog. → roles of Bank + Fund.

- If we don't know enough, let's say so.

Baker Initiative Paper: Argentina

1. Economic Performance in Recent Years

Argentina in most of this century has suffered more than most countries from a poor political milieu and inappropriate economic management. In Table 1.1 recent data suggest the roller-coaster nature of selected economic aggregates.

loss of output?

During the period 1979-82 Argentina suffered external shocks equivalent to 4 percent of GNP. These were due primarily to deterioration in terms of trade and a rapid increase in interest rate. The policy response was primarily to resort to additional net external financing. This was accompanied by some contraction of economic activity. This effort was more than offset by deterioration in export promotion and a rapid increase in imports ("import promotion").

Tabel 1.2: External Shocks

What does this table mean?

External Shock % of GNP	Policy Response As a percentage of GNP			
Average 1979-82	Add Net External Financing	Export Promotion	Import Substitution	Macro Policy Effects
4.0	6.5	-1.5	-2	1

These external shocks and the poor policy response were further compounded by the Malvinas war and the concomitant political instability so that eventually the economy was left in tatters.

Table 1.1: Historic Data

	1978	1979	1980	1981	1982	1983	1984	1985*
Real GDP Growth Rate Per Annum	-3.4	6.7	0.7	-6.2	-5.2	3.1	2.0	-1.0
Debt to Export Ratio 1/	1.62	1.98	2.52	3.09	4.58	4.84	4.91	5.0
Interest Payments to Export Ratio (%) 2/	18.38	22.92	24.18	17.17	25.55	45.35	39.71	
Total Debt to GNP 3/	0.19	0.18	0.18	0.30	0.67	0.71	0.69	0.70
Interest Payment to GNP (%) 4/	2.18	2.06	1.73	1.70	3.76	6.36	5.59	
Debt Service Ratio (%) 5/	45.54	52.57	48.27	34.62	39.41	58.06	47.17	
Capital Fligth (cumulative) (US$ Millions)								25000
Terms of Trade	78.3	82.9	93.8	106.7	92./4	88.3	93.0	89.3
Growth Rates of Imports	-4.9	45.4	45.4	0.4	-41.2	-2.4	1.5	-10.0
and Exports	12.2	-3.0	-4.9	5.9	-2.4	11.5	-1.2	4.6
Current Account Balance (US$ Millions)	1833	-537	-4767	-4714	-2357	-2461	-2492	-1700

1/ Total debt including short-term/exports goods and NFS
2/ Interest payments in MLT/EGNFS
3/ Total debt including short-term/GNP
4/ Interest payments on M&LT/GNP
5/ Debt service on M&LT debt/exports goods and NFS
* Estimate

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The Alfonsin democratic government took office in 1983. They faced a difficult political situation following the recent military adventures together with an economy in disarray. Inflation was running at close to 20 percent per month, the fiscal deficit was about 16 percent of GDP, while the external debt was in excess of US$45 billion (Debt 70 percent of GDP, interest payments 9 percent of GDP). Most social groups greeted the democratic government with strong expectations for improvement in their living standard after a period of economic stagnation.

The Government first sought to address the situation with a gradualist approach. There was a modest gain in real output. However, in order to finance a seemingly chronic public sector deficit, the Government was obliged to resort to domestic sources. This in turn produced a steady increase in inflation.

2. Economic Policy in 1985

As economic activity seemed to be perilously close to complete chaos, the Goverment changed gears and moved to shock treatment in midJune 1985. President Alfonsin staked his reputation on the Austral Plan. The main features were:

2.1 Austral Plan

- Temporary wage-price controls. A number of critical prices were adjusted in advance. These included various public sector prices and a sharp devaluation to ensure a large surplus in the trade balance.

- The budget deficit was reduced significantly by increased tax revenues and lower Government expenditures.
- A monetary reform to defuse the possibility of large transfers from debtors to creditors on outstanding contracts. This would result as real interest rates could surge under falling inflation rates. A new currency, the Austral, was introduced pegged to the US dollar (0.8 Austral = US$1).

2.2 Results to Date

The program has now been in operation over four months and the results to date have been quite spectacular. Some indicators are given in Table 2.1.

- Inflation: Monthly inflation has falled from 30 percent in May to 1.9 percent in October.
- Budget Deficit: Budget deficit was 12 percent of GDP in 1984 and is on track to fall to 2 percent for the last six months of 1985.
- Interest Rates: Nominal rates have fallen dramatically but real rates are still high estimated at 4.2 percent during October.

Perhaps even more important is the political impact of the plan. Opinion polls suggest overwhelming support. In the elections of November 3, President Alfonsin's party made strong gains in some provinces. However, their share of the overall vote fell to 44 percent from 48 percent, suggesting that economic progress is required if the current political support is to be sustained. In essence, this means that growth and real wages must soon achieve forward momentum while ensuring that achievements on the inflation front are consolidated. The official unemployment figures tend to be low in Argentina because of the

Table 2.1: Selected Macroeconomic Indicators

	1982	1983	1984	1985								
				I	II	III	M	J	J	A	S	0
Real GDP	89	92	93	95								
Industrial Prod.	80	88	91	85	83	89	85	79	77	81	84	
Real Wage	80	100	120	136	131	112	138	123	115	112	109	
Open Urban Unemployment (percent)	4.7	4.0	3.8									
Parallel $ Premium Percent above Offical Rate	61	41	31	27	19	19	18	8	18	19	19	15.5
Budget Deficit		12	11	11	12.5	2.0*						
Inflation	187	380	659				25	31	6	3	2	1.9
Real Interest Rate	0.2	3.1	1.1	1.7	-5.4	5.7	2.6	-14.8	5.8	5.2	6.0	4.2
Real Effective Exchange Rate (1980-82=100)	75.9	71.2	79.9				76.7	75.6	68.1	67.1	67.8	

*Target

Notes: Real GDP, Index 1980=100; Ind. Production, 1980=100; Real Wage, Index 1983=100; Real Monetary Base, Index 1983=100; Parallel Dollar Premium, percent of Official Rate; Budget Defit, including Central Bank, percent of GDP; Inflation Rate of the CPI, annual rate except for 1985 where monthly rate is given; Real Effective Interest Rate, percent per month, using WPI as deflator.

See Dornbusch/Morgan Guarantee

particularly institutional arrangements in that country so that the pecipitous fall in the real wage is a better indicator of the burden of the adjustment program on some groups.

3. Major Problems and Policies Needed

In this section a number of major problems are identified. Given the recent (and not so recent) history of Argentina one cannot overemphasize the political dimension in designing a viable economic policy package. It is essential that the current fragile political concensus be strenthened quickly. In economic terms this includes the need to resume growth without the destabilizing effect of inflation. This in turn requires a judicious blend of fiscal, monetary and price (exchange rate) policy. These policies should be pursued in a pragmatic manner such as has been shown in the application of wage-price controls since June. Thus as monetary policy is moved to an expansionary mode to provide adequate liquidity for growth inflationary signals must be acted on promptly and policies modified rapidly.

Does this mean something?

??

A broad outline of macro policy is now suggested. Details at the sectoral level are given in Annex 2. There is no cut and dried optimal policy package. Accordingly these policies may be modified to suit the political milieu and the current and prospective institutional reality. Accordingly they derive from and expand on recent policy initiatives which seem to be quite well designed to meet short-term needs and even more important have some political feasibility.

3.1 Fiscal Policy

Budget Deficit: The dramatic improvement in the budget deficit was achieved by (a) increasing public sector prices and a sharp one-time increase in real tax revenues due to fall in inflation; (b) introduction of emergency taxes on exports and imports; (c) reduction of expenditures including a 30 percent cut in real wage. In order to improve exports performance and productivity these emergency export taxes must be removed while taxes and non-tariff barriers on imports must be rationalized. What does this mean?

Of what?

In the short term much of the shortfall will be taken up by the Agriculture Loan (World Bank). This will provide room to introduce broad based taxes such as a wealth/land based tax. At the same time, administrative reform of other revenue sources, such as value-added tax, income and social security must proceed.

Will that be enough? What about political support for land taxes

3.2 Monetary Policy

During the high inflation period preceding the June 1985 initiative the monetary base shrunk to 1 percent of GDP, thus removing the possibility of a viable source of financing. Since the June plan this has increased by about 100 percent. However, to avoid any deterioration in inflationary expectations this growth must be kept under tight control.

The real annual interest rate is still (October) around 40 percent. This in turn is a major deterrent to productive investment.

? So what does one do?

The dilemma is that the Government must avoid any deficit financing by resorting to the printing press. However, if credit is too tight real interest rates will remain high. Most government financing will have to be done by monetizing capital inflows. As the program gains increasing credibility some of the other factors keeping real interest rates high may recede. These include: general confidence in the system which though improving is still not high enough to trigger major investment expenditures by the private sector: current banking costs are estimated at 2 percent per month; the anticipated financial sector reform should reduce this to 0.5 percent. If real interest rates do not fall soon (and realistically one cannot count on it) then some vehicle must be provided to channel investment funds to the private sector at lower rates. What is keeping them high?

3.3 Prices/Exchange Rate/Wages

Wage-price controls are not accompanied by a major institutional/bureaucratic network and this should facilitate their removal. However, there is still the difficulty of avoiding a wage/price spiral. The sharp devaluation (18 percent) which preceded the June 14 plan provided some cushion but further measures are needed. Rationalization of the import regime could help while a trade loan (World Bank) would ease the transition for the industrial sector from its privileged import subtituting status. Hopefully, this will avoid the excesses of the Martinez de Hoz "import promotion" period. Much of the "danger" of a fixed exchange rate has been reduced by the adoption of a pragmatic price/incomes policy. This provides an excellent countervailing instrument to any destabilizing price increases.

money? policies?

What does this mean?

Much of the potential inflation can be avoided if real wages are contained, however, this will also pose political difficulties. Here productivity growth is needed. How will it come about?

In summary, what is needed is higher growth financed by monitizing external capital flows. This should be done while continuing with low budget deficits and concomitant low inflation rates. This can be facilitated by a number of positive trends in certain key areas.

3.4 Policy Summary

Domestic

1. Improved fiscal performance to maintain total revenues at around 25 percent of GDP and overall deficits of less than 2 percent of GDP. How will this be done? Over what time period?

2. Lower domestic real interest rates--these must be reduced to less than 15 percent real (annual). Possible financinal sector reform will help but may not be fast acting enough so that alternative arrangement is needed for transition period. like what

Not policy but outcomes

3. Increased productivity. The historic record suggests that Argentina can achieve 3 percent annual productivity growth (compared to -0.5 percent over 1981-84). How?

External

1. Higher export levels--Ideally this can be achieved with better access to OECD markets and improved terms of trade, but should be accompanied by reduced export taxes, an attractive real exchange rate, and generally stronger incentives. ?

2. Improved capital flows. This would require a higher volume of net transfers, preferably at lower costs. This is connected intimately to the medium term development strategy. In recent years Argentina has had gross domestic saving about 18 percent of GDP. However, net factor service income currently requires around 8 percent of GDP. Thus the medium term growth prospects could be improved either by increasing domestic savings substantially or reducing the factor service payments. In the current political situation it is extremely unlikely that domestic saving could be

What is the likelihood?

What is this?

increased by more than two or three percent as the resulting short term economic contraction might prove to be untenable. Whether factor service payments could be reduced is also a largely political question. New money for increased imports might produce a similar effect since it would be largely fungible and might be more politically acceptable. The high case scenario in the next section can be also interpreted in this manner. In the medium term one can expect a resumption of direct investment flows and a reversion of at least some of the estimated US$25 billion of capital flight.

We now proceed to quantify some of these paramenters and indicate some of the orders of magnitude involved.

4. Projections

This section presents two projections (1985-95). The base case represents the best estimate of economic aggregates under the current policy milieu. A high case alternative is then discussed. i.e. no policy change?

- Base Case

There are two sets of assumptions underlying the base case relating to the external (world) and domestic economic. The external assumptions are given in Table 4.1. Note in particular the OECD growth rate is expected to be slightly over 3 percent annual.

Domestic assumptions are summarized in Table 4.2. The principal assumption is, that the stable political situation should be reinforced so that the policy initiatives of June can be maintained.

- Results -- Base Case

The results are summarized in Table 4.3. The GDP annual growth rate goes from 2.7 in 1986 to reach a sustainable level of 3.5 in 1990. Continuation of the Austral plan policies locks in the improved public sector performance. Improved collection of value added, income and social security, and a broad based land tax should help to offset removal of emergency trade tariffs, and keep public revenues around 24 percent of GDP. Factor payments as a share of GDP would show a slight fall, helping to accommodate a modest rise in public investment share so that the overall public sector deficit would remain close to -2 percent. This is essential to sustain the recent strong performance in controlling inflation. On the external side an even keel policy in exchange rates, together with a three percent OECD growth and continuing success in extra OECD markets would enable exports to increase to US$14.1 billion (current US$) by 1990. This would help reduce the current account balance to US$-0.5 billion by 1990. Total debt outstanding would rise by US$2.5 billion over the period, while the debt service ratio (DS/XGS) would improve from 85 percent in 1986 to 65 percent in 1990. Estimate of the financing needs are given in Annex 2.

- High Case/Growth Scenario

The high case scenarios assumptions are summarized in Table 4.2. The conceptual framework may be outlined as follows. Prospects for sustained higher growth levels together with improved financial resources available to cope with external debt burden requires a stronger export performance. Some improvement may be expected from wheat exports, particularly in non-OECD markets but the major improvement will eventually have to come from manufactured exports. These in turn will require easier access to imports as industry is upgraded. This high case seeks to model the stylized facts by introducing a strong boost for imports in 1986 and then falling to historic import elasticity levels by 1988 and onwards. This new money for higher import levels may be also interpreted as providing funds to offset some of the factor service burden and through this avenue releasing additional resources for investment. This interpretation may be seen by noting the identity (simplified)

not agricultural ?

Current balance = exports - imports - factor service payments
= net capital needs

?

For a given current balance or equivalenly a given net capital availability any increase in factor service payments must be offset by reduced imports. Similarly imports may be increased either by lower factor service payments or increased net capital availability. This in turn can lead to higher exports in the medium term. Estimates suggest that the elasticity of GDP with respect to total capital stock is about 0.3. Consequently well directed investment can be quite rewarding in the medium term.

?

In the short run this will induce deterioration in the current balance. The debt figures will also get worse during this readjustment as the shortfall cannot be offset by monetary emission. Otherwise the inflation cycle will be reactivated. This in turn requires new money to effect the transition.

The results are summarized in Table 4.4. Because of larger import levels GDPMP growth would initially be a little lower in 1986 than in the base case, but by 1990 would move to higher level over 6 percent annual. This in turn should help realize some of the heretofore unfulfilled expectations. The public sector accounts would still be held to current levels.

The current account balance would show some deterioration in 1986 compared with the base case, but by 1990 would have recovered to the anticipated level of the base case. Debt service requirements would increase but the DS/XGS ratio would vary little because of higher export levels. The high case would require additional financing of about US$640 million net in 1986, rising to US$742 million net (US$991 million gross) in 1990. This additional flow would then be reduced rapidly if exports (net of imports) continued to show improvement.

Where is this coming from?

DATE : 10/29/85

Table 4.1 Assumption--External (Central Case)

	1970-80a/	1981	1983	1985	1986	1987	1988	1989	1990	85-90	90-95	85-95
Percentage Change per year												
GDP Growth in Industrial Countries (Real)	3.2	1.6	2.3	2.7	2.7	3.3	3.1	3.1	3.2	3.1	3.4	3.2
Europe	2.9	0	1.0	1.9	2.3	2.4	2.5	2.6	2.7	2.5	2.9	2.7
Asia	4.6	3.9	2.8	4.8	3.8	4.0	3.9	3.9	4.0	3.9	4.2	4.1
North America	3.1	2.6	3.5	2.6	2.6	3.9	3.4	3.3	3.3	3.3	3.5	3.4
US$ GDP Deflator for Industrial countries	10.1	-1.6	0.2	1.0	8.0	8.1	8.7	8.6	8.3	8.3	4.5	6.4
National Currency GDP Deflator for Industrial Countries	7.8	6.9	4.0	3.3	3.4	3.6	3.9	4.0	4.3	3.8	5.0	4.4
MUV Index (in US$)	12.3	0.5	-1.2	-0.5	7.0	7.0	7.5	7.7	7.6	7.4	4.5	5.9
Exchange Rate b/	3.2	-10.8	-3.6	-2.5	4.0	3.6	3.7	3.1	3.3	3.5	0	1.8
GDP Deflator for the U.S.	6.9	9.2	3.8	3.5	4.0	4.5	5.0	5.5	5.0	4.8	4.5	4.6
Non-oil Commodity Prices (Nominal)	12.3	-12.0	7.3	-9.1	2.9	9.0	9.0	9.1	9.3	7.8	5.1	6.4
Non-oil Commodity Prices (Real) c/	0	-12.5	8.6	-8.6	-3.9	1.8	1.3	1.4	1.6	0.4	0.6	0.5
Oil Prices (Nominal)	36.8	12.5	-12.3	-3.5	-3.3	5.2	5.2	5.3	5.0	3.4	8.6	6.0
Oil Prices (Real) c/	22.1	11.9	-11.3	-3.0	-9.7	-1.7	-2.1	-2.2	-2.4	-3.7	4.0	0.1
Average Annual Rate												
US Nominal Interest Rate d/	8.6	16.6	9.8	9.0	9.0	9.0	9.0	9.0	8.5	8.9	8.0	8.5
US Real Interest Rate e/	1.7	7.4	6.0	5.5	5.0	4.5	4.0	3.5	3.5	4.1	3.5	3.8

a/ Average rates for the period 1970-80 were calculated using geometric averages.
b/ The rate of change of the US$ GDP Deflator minus the rate of change of the US GDP Deflator. This represents the change in the real dollar exchange rate relative to all industrial countries currencies.
c/ Deflated by the MUV Index (= Unit Value Index of manufactured exports from industrial to developing countries).
d/ Six-month dollar LIBOR. Owing to the lack of historical data, the 1970-80 average uses three-month dollar LIBOR.
e/ The US nominal interest rate minus the rate of change of the US GDP deflator

Table 4.2: Selected Assumptions -- Domestic

	Annual Growth Rates				
	1986	1987	1988	1989	1990
Base Case					
Government Consumption	0.5	0.5	0.5	0.5	0.5
Private Investment	3740 1/	6.0	8.0	8.0	8.0
Government Investment	4.0	5.0	7.0	7.0	7.0
Exports					
Wheat	5.0	5.0	5.0	5.0	5.0
Manufacturing	5.0	5.0	5.0	5.0	4.5
Imports					
Inter. Goods Elasticity	1.0	1.0	1.0	1.0	1.0
High Case					
Government Consumption	1.5	1.5	1.5	1.5	2.0
Private Investment	3740 1/	7.0	9.0	9.0	9.0
Government Investment	5.0	7.0	9.0	9.0	9.0
Exports					
Wheat	6.0	6.0	6.0	7.0	7.0
Manufacturing	5.0	5.5	9.0	9.0	9.0
Imports					
Inter. Goods Elasticity	2/	1.5	1.0	1.0	1.0

1/ Private Investment level equal to 1984 level.

2/ Imports restored to 1984 level.

?

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Table 4.3: Base Case--Results

	1986	1990
GDPMP--Annual Growth Rate Real	2.7	3.5
GNP Per Capita (US$ 1983)	$2220	$2440
Government Revenue (% GDP)	24.0	23.3
Government Investment (% GDP)	6.5	7.4
Government Deficit (% GDP) 1/	-2.5	-1.9
US$ current Billions		
Exports	9.2	14.1
Current Balance	-1.5	-0.5
Debt Outstanding and Disbursed	51.1	53.6
DS/XGS percent	85	65

Table 4.4: High Case--Results

	1986	1990
GDPMP--Growth Rate	2.3	6.3
GNP Per Capita (US$ 1983)	$2207	$2602
Government Revenue (% GDP)	24.1	23.4
Government Investment (% GDP)	6.6	7.5
Government Deficit (% GDP) 1/	-2.4	-2.0
US$ Current Billions		
Exports	9.2	15.4
Current Balance	-2.2	-0.8
Debt Outstanding and Disbursed	51.9	55.2
DS/XGS percent	85	63
Additional Financing Needs		
Above the Base Case		
US$ Current Millions		
Gross	640	991
Net (of interest)	640	516

1/ Overall deficit of the non-financial public sector.

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5. Conclusions

In this section we summarize some of the main features.

What is needed--Base Case.

1. Continuation of stable socio-political environment in order to sustain the Austral plan initiative.

2. External: OECD annual growth rates of 3 percent real, interest rates to remain at current levels or fall.

3. Domestic: Public sector deficit must remain at current levels close to zero and for the interim any deficits should be financed by monetizing external capital flows. As inflationary expectations are reduced, the Government might be able to move towards a more expansionary monetary policy to reduce real interest rates. This will have to be done on a gradual testand-see basis. This combined with adequate imports of capital and critical intermediate imports should facilitate growth. Alternately, reduced factor service payments could be used to free up resources for investment. Each percentage point reduction in interest charges would help increase investment by 0.6 percent of GDP.

won't [illegible] return?

for how long?

4. Price/Wages/Exchange Rate: The current pragmatic approach to wage/price controls should continue, especially as a more expansionary monetary policy is introduced. This will be coupled with a reform of the banking system to reduce real interest rates. Wage increases should be linked to productivity

increases. These in turn will come from improved sectoral policies (see Appendix 2 for details) and easier access to critial inputs.

5. Capital flows: The net capital flows required for the base case scenario are US$1.53 billion in 1986. This would drop to US$0.49 billion in 1990.

From where?

What is needed--High Case.

1. In order to stimulate exports one needs to provide further incentives. These could include export insurance, forward exchange markets. In addition, one might give some thought to strengthening the export promotion institutions. In Argentina the production activities are much stronger than the marketing in a number of sub-sectors, and in such areas a specialized marketing operation, possibly trading houses, would be needed as part of overall improvement in the commercial policy. This can be helped by providing sufficient funds for working capital and adequate financing to cover the intervening period between production and export receipts.

Why would [illegible] things? Who set them up?

mandatory?
Is this part of financial reform?

2. Investment levels should be increased by providing increased credit at lower interest rates and focusing on those areas with high anticipated rates of return. This would include the energy and telecommunications sectors which could strengthen both public sector finances and infrastructure for the private sector. This might require substantial lending to the private sector with obvious implications for IBRD/IFC operations and also perhaps

??

needing some sterilized intervention to avoid overheating of the economy.

from where? why?

3. Capital flows: There is also the possibility that direct investment flows may resume at higher levels. One has to seek measures to avoid the destabilizing effect of short term parking. ?

It is possible that longer term capital flows might be stimulated by appropriate incentives/gurantees. The net capital flows required will exceed the base case by US$640 milion in 1986. This net excess would be US$516 million in 1990.

4. Currently Argentina is under an IMF program (up to March 1986). It is the only major debtor country currently in compliance with an IMF program and also eligible for IBRD loans. This program places stringent limits on a number of macro variables. The scenarios in the study are in line with IMF public sector policies. However, IMF monetary guidelines may cause some problems if growth is to be resumed. It will also require some easing of IMF constraints on new external financing possibly before the end of program period in March 1986.

Who? What? Why?

Policy Objectives in Relation to the Bank's Lending Strategy

The Government has articulated a strategy to restore the Argentine economy to a growth path. In connection with short term stabilization policy, on June 15, 1985, it launched a severe adjustment program, based on a temporary wage and price freeze accompanied by a drastic reduction in the fiscal deficit from 12.5% of GDP during the first half of 1985 to 2% of GDP in the last quarter of the year. Besides, the Government committed itself to stop issuing money to finance the fiscal deficit. At the same time it adopted a novel and ingenious disinflation scheme to neutralize the distributional effects of a sudden--and largely unanticipated--decline in the inflation rate. The immediate results of this program were excellent; the inflation rate, that had hovered around 30-35% per month during the second quarter of 1985, declined abruptly to around 2% per month in September-October.

Repeats,

The success of the stabilization program does not imply, however, that the short term adjustment effort is over. Many economically difficult and politically sensitive issues still have to be solved, the most important of which are how to get out of the temporary wage and price freeze without triggering a new inflationary spiral, and how to reduce public expenditures without resorting to massive layoffs. As a result, demand management policies will continue being tight for some time. In this respect, an IMF program is in effect, and the Government has been complying with its targets. The Government's task is facilitated considerably by the fact that the vast majority of the population is solidly behind the austere economic program.

contradicts monetary expansion

The Government also has outlined the components of a medium term strategy to resume economic growth while complying with debt servicing requirements. The strategy, that has been dubbed "positive adjustment", is based on two pivots: the rapid growth of private investment and exports.

Rapid growth of private investment is needed to restore and expand the country's productive capacity, badly battered by many years of economic mismanagement and swiftly changing economic policies. In this respect, in a dramatic reversal of past economic policies, and surmounting strong internal dissent, the Alfonsin administration wishes to make the private sector the main engine of growth, and is in the process of defining an expanded role for it, as well as clearer rules of the game, including a program to privatize publicly-owned enterprises.

There are two main obstacles to the recovery of private investment in Argentina. First, an appropriate business confidence climate is still lacking, for the very same reasons identified in the preceding paragraph. There is, of course, no simple solution for lack of confidence produced by decades of economic mismanagement; the best answer will be found in the soundness and stability of the Government's own economic program. Second, the extremely high level of real (lending) interest rates, caused by an overextended financial system founded on unduly high intermediation spreads, makes investment in fixed assets a relatively unattractive proposition. The Government will address this issue creating incentives for an orderly reduction in the number of financial institutions in Argentina as part of an institutional reform package that would also seek to make the system more competitive; the restructuring of the financial sector would be supported by two proposed financial sector loans. Besides, there are specific issues pertaining to the level and structure of incentives for private sector investment that would be addressed under several sector loans proposed in this document. Like what?

On the production side, output and export growth would mainly originate in three sectors: agriculture, manufacturing, and energy. In addition to the macroeconomic considerations outlined above, setting these sectors in export oriented growth paths will require substantial adjustments in policies. Not much mention in earlier part of the paper.

But earlier the paper emphasizes unfavourable agrarian structure.

Agriculture has been recognized as a sector in which Argentina has comparative advantage and a largely unrealized export potential, especially in grains and cereals. In addition, Argentina's agricultural sector could provide a solid foundation for an export oriented agroindustries subsector. The development of Argentina's agricultural output and exports has been hampered by unfavorable output/input prices that led to underutilization of fertilizers and agrochemicals and correspondingly low product yields. Unfavorable output/input prices, in turn, have been the result of export taxes (imposed by fiscal expediency considerations) and of protection for local producers of certain inputs. The Government plans to address these policy issues through the gradual phase-out of taxes on exports of agricultural products and of taxes on imports of agricultural inputs. The loss of fiscal revenue will be compensated by the introduction of a production-neutral tax on land. These reforms would be supported through two proposed agricultural sector loans.

Time phasing?

Manufacturing also offers good prospects for export oriented output growth, with attendant foreign exchange earnings and employment creation. The main issue is how to redress the strong anti-export bias built onto the complex systems of tariff and non-tariff protection prevailing in Argentina. In this connection, one must remember that Argentina's manufacturing sector is still badly shattered by the unfortunate import liberalization experience of 1976-1981 (incoherently adopted concurrently with a revaluation of the domestic currency). Therefore, the proposed program of policy reforms focuses on achieving neutral status for export industries through the adoption of a flexible temporary admission regime for imported inputs. At the same time, import licensing requirements will be significantly eased up, and export procedures will be simplified. Tariff reform would be limited to reducing tariff dispersion in its first stage. These reforms would be supported through two proposed trade policy loans.

Was import lib. the cause or was it poor macro. pol. that lead to the effects?

Energy has been recognized as Argentina's "new frontier" after significant discoveries of natural gas deposits in the last decade. This expanded resource base could support significant exports of gas products and, to the extent that gas substitutes for oil in domestic consumption, petroleum products also. The Government wishes to make energy production one of the leading sectors in Argentine economic recovery because it could make a significant contribution to ease the balance of payments constraint. But this will call for important policy reforms, including the definition of an expanded role for the private sector, rationalizing the pricing and taxation systems, streamlining the public enterprises operating in the sector, and stepping up energy conservation efforts. These policy reforms would be supported through an energy sector loan.

vague

Finally, reforms of public enterprises in the transport sector are also crucial components of Argentina's development strategy. The reforms are related to the Government's global adjustment efforts because these enterprises are an important drain on the Treasury's financial resources on account of their operating deficits and their investment programs; but, additionally, because their efficiency has an important bearing on the profitability of export oriented domestic productions (i.e. ports, railways). The proposed program of reforms would include rationalizing medium term investment programs, improving decision and monitoring mechanisms, reducing investment requirements through increased private sector participation, and deregulating and privatizing certain sector activities. These policy reforms would be supported through two transport sector loans.

During the last decade, a marked deterioration in Argentina's educational system has become apparent. The reduction in the resources made available to the sector resulted in the decay of its infrastructure as well as in a decline in teachers' real salaries that led many of them into other activities. As a result, the quality of the outputs turned out by Argentina's educational system is no longer what it used to be two or three decades ago. This situation compounds the problem created by the emigration of Argentine professionals and technicians to an extent that, some analysts feel, it may no longer be accurate to characterize Argentina as a country "rich in human resources". At least not as much as it used to be. At this point it would be premature to propose a lending operation in education, both because our knowledge of the sector is limited and because the Government is not likely to have the financial leeway to undertake a major effort in this sector for some time to come. Nevertheless, it would make sense to start the groundwork for a possible lending operation in the medium term. In this connection, a sector review might be an effective -- though deliberately unhurried -- way of reopening the sector dialogue with the Government.

Profound, as well as deeply entrenched, are the problems that have beset Argentina for so many years. The development strategy and attendant policy reform programs outlined in the preceding paragraphs constitute a consistent and formidable package. In the process of refining and implementing its program, the Government of Argentina is likely to encounter resistance by various political and social groups. What follows is a capsule analysis of the main problem areas. ?

Privatization efforts in all sectors are likely to be resisted, even by some groups within the ruling Radical Party. Mild estatism has been a component of this party's old ideological baggage, and it still shows, especially in some of the older leaders. President Alfonsin, however, has shown that he is determined to lead the way in this respect

Interesting aspects of political economy and is having a deep impact on some of the younger leaders in his party. Resistance to privatization is likely to diminish as the Government progresses down this road and the process yields its expected benefits.

Wishful thinking?

Financial sector reform is likely to be resisted by the owners and managers of those financial institutions that are least likely to survive. Since restructuring will unavoidably imply the closing down of some institutions and branches, it must be expected that at several points in time the bank employees' union will agitate to defend its members' jobs. Pressure will be applied on the Government to absorb the redundant employees and--of-course--the Government will not be in a position to oblige. Social unrest and turmoil will probably be a permanent feature surrounding this sector for some time.

The reform of agricultural sector policies will be supported by the most progressive agricultural producers and criticized by the most conservative, that are dead set against a land tax. Within the Government, the Secretary of the Treasury is justifiable uneasy about the elimination of taxes that are very easy to collect (export taxes) and their replacement by a new tax that may prove harder to collect (the land tax), and whose yield is to some extent indeterminate, at a time of great fiscal astringency.

Contradicts earlier statements about replacing x taxes w- land taxes

Last but not least, trade policy reform is an extremely sensitive area. As mentioned before, the previous import liberalization attempt was a bitter disappointment; entire industries disappeared, industrial employment declined in absolute terms, and small and medium scale industries were particularly hard-hit. And the country had nothing to show for it. For this reason, the program of trade policy reforms focuses on achieving neutral status for export industries, shying away from a comprehensive tariff reform that would decrease average effective protection and its dispersion. In fact, the program is limited to decreasing the dispersion in effective protection. This would be a way of maintaining the dialogue open on an issue whose sensitivity might diminish in a few years. Proceeding differently--that is to say, raising the issue of decreases in average effective protection at this point--would be extremely counterproductive. Argentine business and labor leaders would present a united front against it. The investment climate, that the Government is painfully trying to reconstruct, would deteriorate sharply. And the Bank's dialogue with the Government of Argentina would be seriously jeopardized.

Draft for comments
11/18/85

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ARGENTINA

RECENT ECONOMIC PERFORMANCE

This paper discusses the current state of the Argentine economy with the purpose of identifying the critical factors that are preventing sustainable growth. In Section I the contraction of 1980-84 is analyzed from a long-run perspective. I claim that the increasing disruption of the political system since 1930 has been decisive for the poor long-run performance of the Argentine economy. After 1970 that disruption took new force and direction with major economic consequences.

In sections II and III the analysis centers on two of those consequences: the accumulation of debt and the accelaration of inflation. As shown in section II that accumulation has implied a severe burden to the relatively closed Argentine economy and the service of the debt has become a critical constraint on growth. Debt restructuring has being alleviating this burden, but it still is too large. As discussed in section III, inflation became the main economic sympton of an unsettled political system, which has increasingly failed to maintain some minimum fiscal and monetary discipline and exacerbated the struggle over income shares. In June 1985 the Argentine Government finally reacted to the threat of hyperinflation by implementing the "Plan Austral". The success of this stabilization program is critical for the prospects of growth. In section III we discuss the program and the results of the first five months of its implementation.

I conclude that, because of the constraints imposed by the unsettled political system, additional foreign funds are very likely to aggravate the burden of debt, with no significant impact on growth. Only upon the settlement of the political system those constraints can be removed and stabilization be durable. There is no role for the World Bank in that settlement, but it can provide technical assistance to Government and Congress as well as commit financial support to the private sector once substantial progress is made in settling the political system. In the meantime the appropriate strategy for creditors is to write-off, unconditionally, part of the Argentine debt.

I. LONG-RUN STAGNATION AND THE CONTRACTION OF 1980-84

1. In 1980-84 the absolute decrease in output and the evolution of other economic indicators point to some kind of collapse. This performance has not paralell in the history of Argentina, even though it may be viewed as the final stage of a long period of

stagnation. A quick review of output growth in this century (Table 1) indicates at least four periods:

(a) Up to 1930 Argentina could absorb a large immigration while output per capita increased at a high rate relative to other countries. In 1929 output per capita was half of that in the United States and 3.6 times greater than in Brazil.

(b) Between 1930 and 1955 output per capita increased at a lower rate than in the previous period, but the relative position of Argentina did not deteriorate. Argentina suffered as much as other countries during the Great Depression, but the war affected her very little. By 1955 growth was already lagging vis a vis the recovery of industrial countries and the development of other Latinamerican economies.

(c) Between 1955 and 1970 output per capita increased at a high rate in comparison with the two previous periods, but that performance was very poor in relation to the rest of the world. The relative decline of Argentina, which has started around 1950, was substantial with respect to other developing countries; for example, while in Argentina output per capita increased 40 % between 1950 and 1970, in Brazil it doubled.

(d) Since 1970 output per capita increased first at a declining rate and finally has decreased to its 1965-69 level. The deterioration vis a vis other countries has been extraordinary. In 1981 output per capita was only 20 % of that in the United States and 15 % higher than in Brazil.

2. Between 1950 and 1980 the path of most economic aggregates was consistent with the low growth in output, but there were some

breaks first after 1955 and then after 1970. Trends in income and absorption were in line with the trend in output during 1950-80 (Table 2), but there were a number of short-lived imbalances that called for stabilization programs. After 1955 growth in output accelerated and there was a significant change in the composition of domestic absorption (Table 4). The increase in investment, financed by domestic savings, was important and the marginal productivity of capital did not decline (Table 13). The composition of output continued shifting in favor of manufacturing industry, but agriculture and other primary activities started to recover (Table 3). In the 1970s there was no change in the composition of domestic absorption but the marginal productivity of capital declined substantially. In addition, the decline of manufacturing industry implied a significant shift in the composition of output and employment (Table 3). These changes were indicating that the declining trend in output growth would continue in the 1980s, but there was no evidence about the possibility of a sharp contraction.

3. Between 1950 and 1980 there were no major changes in the role of the external sector at the aggregate level, regardless of the extensive discussion about trade and financial policies. Only between 1955 and 1970 the ratios of exports and imports to GDP increased slightly (Table 5), but they continued being very low in relation to the 1920s. Only exceptionally the current account deficit was significant (in 1951 and 1961 and to a less extent in 1952, 1955, 1971 and 1975); in fact, the current balance did not

show any trend (Tables 5 and 6).

4. Between 1950 and 1980 there was a significant increase in the size of the public sector (defined broadly as in Tables 9 and 10). However, all this increase took place after 1970. Between 1955 and 1965 there was some contraction in the public sector, first in current expenditures and during the 1960s in capital expenditures. Since 1970 the increase in total expenditures has been substantial, but not continuous. The immediate causes of this increase have been the social security system (line "Transfer" in Table 9), the current expenditures of public enterprises (most of "Goods and services" in Table 9), and the capital expenditures of all the public sector. The growing difficulties to finance the public sector resulted in a huge expansion of debt and consequently in an increase in interest payments. In the 1950s the size of the public sector was already considered detrimental to economic growth, which motivated the subsequent contraction, while in the 1970s the public sector was increasingly perceived as crowding-out the private sector and as wasting large amounts of resources.

5. Output per capita declined 13.5 % between 1979 and 1984 and there is no reason to argue that the 1979 level was exceptionally high. The latter was in line with the declining growth trend and there is no evidence that it was caused by an autonomous expansion in domestic absorption (Table 2). As shown in the statistical tables, there were two major changes between 1975-79 and 1980-84. First, domestic absorption increased sharply with

respect to income, as measured by GNP, and this gap was financed with a loss of reserves and an increase in debt. However, domestic absorption increased slightly with respect to output, measured by GDP. Second, as result of the large increase in interest payments to the rest of the world, income declined with respect to output (Table 2). Given the sequence of events and the fact that output increased very little in 1980 and declined substantially in 1981, it can be concluded that initially there was a large expenditure switching from domestic to imported goods and services which fed back the contraction of output via the negative effect of larger interest payments on income. As result of this process --in addition to the sharp decline in output, income and domestic absorption-- the net foreign debt increased 35,466 millions of US dollars (Tables 7 and 8). In the following section we analyze the details of the debt problem.

6. In 1980-84 other economic trends were broke. First, there was a significant change in the composition of domestic absorption. The fall in investment --both in absolute terms and in relation to GDP-- has continued up to 1984. This fall has been aggravated by a negative marginal productivity of capital. Second, employment has increased slightly, also with a negative marginal productivity, but not enough to prevent an increase in unemployment (Table 12). Third, the composition of output has finally shifted in favor of agriculture and other primary activities. Fourth, there has been a large increase in the ratio of exports to GDP, mainly as result of the expansion of exports

(Table 5). Fifth, there was a sharp increase in total expenditures of the public sector, from 47.9 % of GDP in 1975-79 to 60.6 % in 1980-84 as measured in Table 9, to which it has to be added the quasi-fiscal expenditures of the Central Bank (according to some estimates the latter were as high as 20.9 % of GDP in 1982 and 10.3 % in 1983).

7. Even though the long-run stagnation of the Argentine economy cannot be explained by external factors, the contraction of 1980-84 is largely "explained" by the accumulation of foreign debt and by the increase in international interest rates. There was a significant, exogenous change in the availability of foreign credit and this change was a necessary condition for the contraction. However, one has to question the rationality of a policy that implied a large expenditure switching to imported goods and services, without any expansionary effect on domestic output. I think this expenditure switching was an unintended and unforeseen consequence of inconsistent economic policies and the political system failed to react promptly to change these policies.

8. The Argentine political system has been ineffective to respond both to unsettling economic conditions and to new opportunities in the world economy. The struggle over power and income has pervaded the policy output of the political system. This output has experienced violent swings as shown, for example, by the frequency and magnitude of changes in relative prices (Table 11). Furthermore, the few long-term trends in that output --that is,

the expansion of the public sector, the politicization of the private sector, and the closing of the economy-- have been dysfunctional to efficiency.

9. The inefectiveness of the political system can be traced to the crises of participation and of legitimacy that led to the breakdown of constitutional democracy in 1930. The institutional conciliation of mass participation and democratic legitimacy failed then and has proved to be very elusive in the last 55 years. Lack of effectiveness in the management of the economy undermined successive governments, feeding back the crisis of legitimacy and exarcebating the struggle over power and income.

10. After 1970, as result of the economic and political failure of the Ongania Government, the disruption of the political system took new force and direction. The new force, as shown by the passive acceptance of violence as part of political confrontation, resulted from defiance to the power of the military, which could not longer oppose the participation of the Peronist party. The new direction resulted from non-responsible authority as the form of government accepted first by the Peronist party and then by the military. These political developments have a major impact on the economy, causing the crisis of 1980-84.

II. THE ACCUMULATION AND SERVICE OF FOREIGN DEBT

11. By 1975 foreign debt was not a burden, even though its level in relation to exports was high (Table 8). Since then, three periods can be identified in the development of the Argentine debt problem:

(a) up to 1979 there was a significant increase in the dollar amount of foreign debt, but it declined with respect to exports, and most of the increase was paralleled by accumulation of reserves by the Central Bank; furtermore, in this period there was a superavit in the current account;

(b) between 1980 and 1982 the debt increased sharply both in dollar amount and in relation to GDP and exports, and at the same time there was a large loss of reserves; in this period there was a huge deficit in the current account; and

(c) since 1982 the foreign debt has continued increasing in dollar amount but not with respect to GDP and exports, the Central Bank has been able to stop the loss of reserves and the deficit in the current account has been reduced.

12. In 1976-79 economic policy was aimed at correcting the imbalances inherited from the Peronist Government (May 1973-March 1976). After the initial measures to correct the external imbalance, the stabilization program was based on:

(a) a reduction in the deficit of the public sector, with the remaining deficit being financed by domestic and foreign credit, but not by the issue of money;

(b) a restrictive monetary policy, which implied that monetary expansion to meet the demand for high-powered money was to come from the accumulation of reserves; and

(c) expectations management, which relied upon direct and indirect price controls (wage freeze, tariff reductions, price truces, voluntary agreements, and finally the preannouncement of the exchange rate).

All the three components of the stabilization program were unsustainable:

(a) the deficit of the public sector continued being very high to be financed with debt because interest payments would have created an explosive path;

(b) the inflation rate continued being very high (Table 1) and so did the flow demand for high-powered money to keep real balances constant; the attempt to meet this demand with the accumulation of reserves, which in turn called for a superavit in the current account and/or a large inflow of foreign credit, implied a heavy burden for the private sector; and

(c) expectations management just amounted to repress inflation by controlling some prices, which created sectoral and income imbalances that sooner or later would have to be corrected (so-called "sinceramiento" of prices).

13. The collapse of that stabilization program, which started in early 1980, was followed by a period of great economic and political unrest. The program failed initially because of an autonomous expansion in the deficit of the public sector and of the financial crisis of March 1980, but the increasing perception

of the incoherence of the program was decisive to give rise to the large expenditure switching mentioned in paragraphs 5 and 7. The collapse was aggravated by interest payments on the public debt and capital flight, and later on by a decline in the revenues of the public sector. The economic mismanagement of this period has some parallel with that of other periods in which a stabilization program collapsed (1974-76, 1970-72, 1962); the main difference is the legacy of a huge foreign debt.

14. By the end of 1982 the Argentine Government initiated negotiations with the IMF and with foreign bank creditors to obtain additional funds and to reschedule the debt. The Bignone Government reached an agreement with the IMF which became effective in early 1983 and the Alfonsin Government reached a new agreement with the IMF at the end of 1984. Access to resources under both agreements was quickly interrupted, mainly because the Argentine Government could not remain within the limits set for the major macroeconomic targets of the programs. In August 1985, after the Austral Plan was implemented, there has been a new agreement with both the IMF and bank creditors (see paragraph 31).

15. By the end of 1983 the total foreign debt of Argentina amounted to 46,005 millions of US dollars, of which 32,200 millions (70 %) were due to commercial banks, 5,000 millions to suppliers and other private sources, 4,200 millions to bond holders (other than Bonods and Promissory Notes that are included in the debt with commercial banks), and the remaining 10 % was

due to bilateral and multilateral institutions, including the IMF. It is estimated that by the end of 1985 the total foreign debt will amount to 50,239 millions of US dollars, which would imply an increase in the ratio to GDP up to 0.66, in comparison with 0.61 in 1984. As shown in Table 8 the debt burden is quite heavy, even though in 1983 and 1984 the effective transfer amounted to 5.7 and 5.1 % of GDP respectively, and to 39.1 and 36.6 % of exports respectively (These percents correspond to the trade balance in the national accounts at prices of 1970; see Table 5). In 1985 this transfer would also be around 5 % of GDP and around 36 % of exports. However, measured at current prices, the effective transfer in relation to exports may increase in 1985 as result of the deterioration in the terms of trade, which is now beginning to aggravate the debt burden.

III. INFLATION AND THE STABILIZATION PROGRAM OF JUNE 1985

16. The history of the Argentine inflation started around 1945, and since then two main periods can be distinguished (Table 1). Up to 1970 inflation was high in relation to other countries, but the average rate of inflation was not very high at 24 % per year. A major problem was the great variability of inflation --there were a couple of years in which inflation was as low as 3-4 % and a year in which it was as high as 113.7 %-- which reflected successive periods of acceleration and of stabilization. Since 1971 inflation has been accelerating, up to 60.3 % in 1973, to

444.1 % in 1976, and to around 800.0 % in 1985, which are the years in which major stabilization programs were implemented. Of course, in this second period the variability of inflation has been much larger than in the previous one: the short-run success of the Peronist program implied an inflation of only 24.2 % in 1974, and that of Martinez de Hoz's program an inflation of 100.8 % in 1980.

17. One of the two major causes of inflation is the deficit of the public sector. In paragraph 4 I have already referred to the expansion of this sector, broadly defined as in Tables 9 and 10. Since 1970 current revenues of the public sector have been increasing, but not pari-passu with expenditures. Furthermore, they have shown large swings around that increasing long-run trend, another indicator of the pervasive struggle over power and income as well as of the erosion of the tax base when inflation has been accelerating. The deficit of the public sector averaged only 3.6 % of GDP in the ten years 1961-70 and increased up to 8.7 % of GDP in 1971-75. Initially this increase was financed by the printing of money and later on, in 1977-79 when the deficit declined to 6.1 % of GDP, by domestic and foreign debt. In 1980-84 the deficit has averaged 15.4 % of GDP without taking into account the cuasi-fiscal expenditures of the Central Bank, and half of it has been financed by printing money.

18. The second cause of inflation has been the already mentioned struggle over income shares, which has significantly affected the short-run behavior of both taxes and relative prices. Monetary

policy has frequently accommodated changes in relative prices resulting from increases in nominal prices. Increases in nominal wages, in the nominal exchange rate, in the nominal prices of petroleum and agricultural commodities, have largely been determined by political forces. However, the violent swings in domestic relative prices have not shown well defined trends, even though from Table 11 it can be concluded that in the last 15 years imports have become more expensive.

18. Those adjustments in nominal and relative prices have been complemented by formal and informal indexation. However, indexation has not been as pervasive as in Chile, where a unit of account linked to the consumer price index has been extensively used. Inflation-adjustment clauses have been common in long-term contracts, while the nominal interest rates of financial contracts have usually included some expectation of inflation. Government attempts to index the exchange rate and nominal wages have been very limited. The great variability of inflation has been closely associated to the violent swings in relative prices, which has limited the value of indexation.

19. Major stabilization programs were implemented in 1967-69, 1973-74 and 1976-79. As mentioned these programs had some temporary success in reducing the rate of inflation, but they collapsed and inflation quickly accelerated. These programs reduced initially the deficit of the public sector and attempted to control monetary expansion, but they were aimed at "managing"

inflationary expectations by direct or indirect control of some prices, and this after a new structure of relative prices was set. In the 1967-69 program the initial devaluation was followed by a fixed exchange rate. In the 1973-74 program the initial increase in nominal wages was followed by a wage freeze. In both cases, neither the new structure of relative prices nor the reduction in the deficit of the public sector were sustainable. In paragraph 12 I have referred to the 1976-79 program.

20. In the first 18 months of government President Alfonsin failed to implement a consistent stabilization program, even though the short-lived agreement with the IFM at the end of 1984 revealed the intention of sacrifycing the gains in real wages granted in the previous months (Tables 11 and 15). These gains contributed to the acceleration of inflation during 1984, from 18 % per month in the last quarter of 1983 to 23 % per month in the third quarter of 1984. The breakdown of the IMF agreement implied a new acceleration of inflation, up to 27 % per month in the quarter from March to May. In the meantime, output was declining after the small recovery of 1983-84. In the first quarter of 1985 GDP declined 1.4 % with respect to the same period in 1984, and in the second quarter it declined 3.4 % with respect to the second quarter of 1984. It was in this context that the Argentine Government decided to undertake a new major stabilization program. Some measures were implemented at the end of May and others in early June, but the core of program was announced the 14th of June. The program is known as Plan Austral because of the new unit of money.

21. The Plan Austral is based upon:

(a) A reduction in the deficit of the public sector and a commitment not to finance the remaining deficit by printing money.

(b) An initial realignment of relative prices and the subsequent freeze of the new structure of relative prices.

(c) An attempt to break inflationary expectations by (a) and by a general freeze of nominal wages and prices, including a fixed exchange rate.

(d) A mechanism to adjust outstanding financial contracts to avoid the distributive effect of the immediate and unanticipated cessation of inflation.

22. The measures to reduce the deficit of the public sector included new taxes and an increase in the prices of public utilities and of goods produced by State enterprises as well as a non-discriminatory reduction in wages and capital expenditures. New taxes included an increase in export and import taxes and a forced saving tax. In addition, the average lag in the payment of the value added tax was reduced so in 1985 the Government will collect 13 months of this tax. Tax revenues were also expected to increase as result of the recovery in the base, which was eroded by the acceleration of inflation. As shown in Table 15 increases in the prices of petroleum and other goods produced by State enterprises have been significant, but the increases have been much larger when taxes are included. The increase in revenue

since the Plan was implemented has been extraordinary (Table 15). Annual figures on expenditures and revenues as percent of GDP are presented in Table 10. The deficit is expected to decline up to 5.1 % of GDP for all 1985, even though in the first semester of 1985 it was around 12.5 % of GDP.

23. The Government has committed itself not to finance the remaining deficit by printing money and so far has complied. Before the announcement of the program there was a large monetary expansion to finance the deficit in the second half of June; in early June the Central Bank deposited the equivalent to 25 % of the monetary base at the end of May in the Treasury account at Banco de la Nacion. Since then the Government has been able to finance the remaining deficit with foreign credit. However, there has been some issue of money to finance the cuasi-fiscal expenditures of the Central Bank.

24. The Plan included a change in currency but there was no commitment with respect to monetary policy, except for the non-financing of the deficit of the public sector. The monetary base has increased as result of both the accumulation of reserves and of domestic credit. By September the monetary base, in real terms, had increased around 60 % with respect to June, but it still was about 20 % lower than the average of 1984 (Table 15). Because of the high real interest rates since the Plan was implemented, there has been some discussion about how restrictive the monetary policy should be. The Government preferred to follow a restrictive policy, as shown by the much larger increase in

other monetary aggregates (see in Table 15 the evolution of M2).

25. A significant realignment in relative prices took place just before the 14th of June. First, there was a devaluation of 15 % over the preset value for the 11th of June, but this devaluation was largely compensated by export taxes. Second, prices of imports were also affected by an increase of 10 percent points in the tariff. Third, as mentioned, the prices of petroleum and other goods produced by State enterprises were adjusted before the 14th of June. Fourth, the adjustment in nominal wages was to partly compensate for the inflation between the previous adjustment and the 14th of June. The impact of these changes can be observed in Table 15: in July the official exchange rate was 10.5 % over the May value of the parity rate (25.7 % over the 1970 value of this rate); the prices set by State enterprises increased 14 % in real value between May and July; and real wages in manufacturing declined 10.5 % between those two months.

26. The realignment of relative prices was followed by a general freeze of wages and prices. The exchange rate has been fixed at 0.801 australes per dollar and the prices of petroleum and of other goods produced by State enterprises have also been maintained at their new nominal values. Nominal wages have remained constant, but there is evidence of some adjustments in the private sector via salary advances and other mechanisms. The freeze has been successful in reducing inflation from 27 % per month in March-May to 2.3 % per month in August-October.

27. The great innovation of the Austral Plan was the depreciation of the old money in terms of australes according to a preannounced daily schedule. This "tablita" was to be applied to outstanding financial contracts in which the nominal interest rate included an expected inflation, otherwise the immediate and unanticipated cessation of inflation would have implied a large redistribution of income from debtors to creditors. This redistribution would have in turn threatened the general freeze of prices. The "tablita" was a temporary mechanism and it has already lost any significance.

28. The immediate reaction to the Plan Austral was very favorable, reflecting a consensus about the critical situation that the country was facing. That reaction implied a portfolio shift --a substitution of domestic monetary assets for foregin currency and assets-- and a low cost to enforce the price freeze. After July, that portfolio shift was not enough to quickly reduce real interest rates. More recently, the enforcement of the price freeze has become more difficult. By now inflationary expectations are very mixed. The results of the recent congressional elections (November 3) do not indicate any strong position either in favor or against the Plan Austral.

29. Given the previous experience with stabilization programs, the possibility of a collapse cannot be ignored. Even if the Argentine Government did not reverse its fiscal policy, the program could collapse because:

(a) the freeze of wages and prices will become repressed inflation if there is monetary expansion to finance the cuasi-fiscal expenditures of the Central Bank;
(b) there is an urgent need for flexibility in the structure of relative prices to accommodate real shocks, like a deterioration in the terms of trade; and
(c) real interest rates are too high and may create expectations that the Government will bail-out debtors.
Also, it is not clear to what extent the present structure of relative prices --in particular, real wages-- has been politically validated.

30. Another critical issue is the possibility of a reversal in fiscal policy that may again imply a large deficit. The concern refers both to revenues and to expenditures. The increase in revenues derived from export and import taxes is substantial and therefore it is difficult to substitute new taxes for them. The level of export taxes was high even before the Plan. In addition, the prices of petroleoum and goods produced by State enterprises may be appropriate to finance these enterprises, but they seem to be too high to be politically sustainable and in some cases they may even be too high vis a vis international prices. With respect to expenditures, the Government has attempted to minimize the contraction by emphasizing that the Plan intended to substitute other taxes for the inflation tax. However, there has been a reduction in wages and in the benefits of the social security system that may be unsustainable. The decline in the real value of wages and of those benefits has been too large vis a vis the

decline in the incomes of other groups. Finally, the level of public investment will be very low in 1985 as result of a general cut in programs but not of an economic evaluation.

31. In August the Argentine Government reached a new agreement with the IMF and subsequently with bank creditors.

IV. CONCLUSIONS

32. Three major constraints on growth were identified in the previous sections:

(a) the unsettled political system, which has continuously failed to provide effective responses to changing economic conditions and which has become a major source of economic inefficiency;

(b) the heavy debt burden inherited from economic mismanagement in 1980-82; and

(c) the inflationary pressures derived from the expansion of the public sector and from the struggle over income shares.

33. Those constraints imply a low investment ratio and a very low marginal productivity of capital, and consequently the prospect of stagnation or even decline. Numerical exercises based on extrapolating recent levels of investment and productivity are conclusive (see paper by M. A. Broda and J. C. de Pablo). Debt relief may facilitate an increase in investment, but given the

large holdings of foreign assets by Argentinians it can be argued that debt relief is neither sufficient nor necessary for growth. Only the settlement of the political system may create the incentives both for repatriation of that capital and for a substantial recovery in productivity.

34. Immediately, the Argentine political system faces the challenge of consolidating stabilization. Very strong fiscal and monetary commitments and some truce over income shares are called for getting rid of the general freeze of wages and prices without a revival of inflation. The strength of those commitments and the viability of that truce will depend largely upon the political compromise that the Government is able to achieve with other parties, and first within its own party. Success in getting this compromise will be an indicator that Argentina is starting to settle her political system.

35. The burden of debt is already very heavy and additional foreign funds would increase this burden without contributing to settle the political system. Which is the probability that those funds will be used to finance investment rather than consumption? Which is the probability that, if the funds are invested, productivity will be positive? Will a politicized private sector and an inefficient public sector behave differently? These questions have to be answered by reference to Argetine history, except that there is strong evidence of a significant change in the political system.

35. Debt relief is badly needed just to maintain the 1985 level of domestic expenditure and output, and if the terms of trade do not improve in 1986 that relief will have to increase with respect to its level of 1983-85 (around 2.5 % of GDP). What is the best way for creditors to provide such a relief? Since this relief cannot enhance the prospects for sustainable growth via conditionality, because of the very political nature of the domestic constraint, I think that creditors will have to write-off part of their Argentine debt. Of course, this decision should take into account its effects on other country debtors. However, I think that neither creditors nor Argentinians will benefit from new conditional credits. Creditors will not enhance the probability of a larger effective transfer via new conditional credits. Argentinians will not enhance their prospects of growth.

37. In the absence of appropriate conditions to undertake new significant lending operations, the role of the Bank should be limited to finance small projects of high social profitability and to provide technical assistance with the purpose of enhancing the quality of economic anlysis in political discussion. The Bank should also commit strong financial support for the private sector once substantial progress is made in settling the political system.

TABLE 1. ARGENTINA. GROWTH AND INFLATION

	Total GDP			GDP per Capita			Annual Inflation (%)	
		% Annual Change with Respect to			% Annual Change with Respect to			
	1914 =100	previous period	1900-1904	1914 =100	previous period	1900-1904	Consumer prices	Wholesale prices
1900-04	56.7			93.0			-	-
1905-09	83.8	8.12	8.12	115.6	4.44	4.44	-	-
1910-14	104.9	4.59	6.35	114.0	-0.27	2.06	-	-
1915-19	100.8	-0.79	3.91	94.9	-3.60	0.13	9.92	-
1920-24	134.3	5.91	4.41	112.2	3.40	0.94	-2.60	-
1925-29	174.9	5.42	4.61	125.8	2.31	1.22	-1.34	-
1930-34	178.5	0.45	3.90	113.7	-2.01	0.67	-4.84	-
1935-39	209.5	3.26	3.80	122.4	1.49	0.79	3.54	-
1940-44	241.9	2.92	3.69	130.2	1.25	0.84	2.25	10.93
1945-49	300.5	4.43	3.78	147.9	2.59	1.04	18.87	13.18
1950-54	331.2	1.96	3.59	146.1	-0.24	0.91	20.77	22.02
1955-59	397.2	3.70	3.60	159.6	1.78	0.99	34.90	39.11
1960-64	456.3	2.81	3.54	168.7	1.12	1.00	22.90	21.55
1965-69	565.2	4.37	3.60	191.7	2.59	1.12	21.33	16.77
1970-74	664.6	3.29	3.58	212.0	2.03	1.18	38.14	38.38
1975-79	740.3	2.18	3.49	216.3	0.40	1.13	213.66	205.94
1980-84	736.8	-0.09	3.26	197.5	-1.81	0.95	222.82	232.51
1975	716.1	-0.39		216.8	-2.12		182.8	192.5
1976	712.8	-0.46		212.0	-2.21		444.1	499.0
1977	758.2	6.37		221.6	4.53		176.2	149.4
1978	732.6	-3.38		210.4	-5.05		175.4	146.0
1979	781.8	6.72		220.6	4.85		159.5	149.3
1980	787.3	0.70		218.4	-1.00		100.8	75.4
1981	738.5	-6.20		201.2	-7.88		104.5	109.6
1982	700.1	-5.20		187.3	-6.91		164.8	256.2
1983	721.8	3.10		189.7	1.28		343.8	360.9
1984	736.2	2.00		190.7	0.53		626.7	573.3

Source:
Prepared with data from M.A. Broda y Asociados.

TABLE 2. ARGENTINA. NATIONAL ACCOUNTS: GROSS DOMESTIC PRODUCT (GDP), GROSS NATIONAL PRODUCT (GNP) AND DOMESTIC ABSORPTION

	GDP Millions A$1970	GNP Millions A$1970	GNP % GDP	Domestic Absorption Millions A$1970	% GDP	% GNP
1950-54	4766.5	4757.8	99.8	4815.9	101.1	101.2
1955-59	5713.3	5699.5	99.8	5747.9	100.6	100.8
1960-64	6576.1	6530.3	99.3	6592.5	100.2	101.0
1965-69	8132.5	8036.2	98.8	7973.9	98.0	99.2
1970-74	9397.1	9282.8	98.8	9398.5	100.0	101.2
1975-79	10446.8	10338.8	99.0	10220.0	97.8	98.9
1980-84	10397.1	9851.8	94.8	10239.6	98.5	103.9
1975	10105.3	10035.8	99.3	10275.0	101.7	102.4
1976	10058.4	9913.6	98.6	9762.4	97.1	98.5
1977	10699.5	10577.5	98.9	10339.7	96.6	97.8
1978	10338.8	10230.4	99.0	9800.0	94.8	95.8
1979	11032.2	10936.8	99.1	10922.6	99.0	99.9
1980	11114.2	11002.3	99.0	11565.0	104.1	105.1
1981	10421.2	10139.0	97.3	10708.9	102.8	105.6
1982	9878.6	9181.0	92.9	9461.6	95.8	103.1
1983	10182.0	9357.1	91.9	9606.8	94.4	102.7
1984	10389.5	9579.4	92.2	9856.0	94.9	102.9

Source:
Central Bank of Argentina.

TABLE 3. ARGENTINA. GDP AND EMPLOYMENT: SECTORAL COMPOSITION

	Agriculture	Mining	Manufacture	Construction	Services
			GDP (%)		
1950-54	18.8	0.7	27.7	4.5	48.3
1955-59	17.7	0.7	30.6	3.9	47.1
1960-64	16.3	1.1	31.2	3.7	47.7
1965-69	14.9	1.4	34.1	3.8	45.8
1970-74	13.2	2.3	27.9	6.1	50.5
1975-79	13.6	2.3	26.7	6.8	50.6
1980-83	14.3	2.7	23.5	5.7	53.8
			EMPLOYMENT (%)		
1960	20*		28	6	46
1970	16*		21	9	54
1980	13*		21	11	55

* All primary activities.

Sources:
Central Bank of Argentina and INDEC.

TABLE 4. ARGENTINA. NATIONAL ACCOUNTS: CONSUMPTION, INVESTMENT, AND SAVINGS

	Consumption		Investment		Domestic Savings		Foreign Savings	
	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP
1950-54	4035.8	84.7	780.1	16.4	722.1	15.1	58.0	1.3
1955-59	4834.5	84.6	913.4	16.0	864.9	15.1	48.5	0.9
1960-64	5265.2	80.1	1327.3	20.2	1265.1	19.2	62.2	1.0
1965-69	6401.3	78.7	1572.6	19.3	1636.7	20.1	-64.1	-0.8
1970-74	7406.0	78.8	1992.5	21.2	1876.9	20.0	115.6	1.2
1975-79	7943.2	76.0	2276.8	21.8	2395.5	22.9	-118.7	-1.1
1980-84	8456.8	81.3	1782.8	17.1	1395.3	13.4	387.5	3.7
1975	8233.2	81.5	2041.8	20.2	1802.6	17.8	239.2	2.4
1976	7589.0	75.4	2173.4	21.6	2324.6	23.1	-151.2	-1.5
1977	7745.0	72.4	2594.7	24.3	2832.2	26.5	-237.5	-2.2
1978	7599.5	73.5	2200.5	21.3	2630.9	25.4	-430.4	-4.2
1979	8549.4	77.5	2373.2	21.5	2387.4	21.6	-14.2	-0.1
1980	9020.7	81.2	2544.3	22.9	1981.6	17.8	562.7	5.1
1981	8752.4	84.0	1956.5	18.8	1386.6	13.3	570.0	5.5
1982	7804.7	79.0	1656.9	16.8	1375.5	13.9	281.4	2.9
1983	8090.1	79.5	1516.7	14.9	1269.4	12.5	247.3	2.4
1984	8616.0	82.9	1240.0	11.9	963.4	9.3	276.6	2.6

Source:
Central Bank of Argentina.

TABLE 5. ARGENTINA. NATIONAL ACCOUNTS: EXPORTS, IMPORTS AND FACTOR INCOME

	Exports		Imports		Net Factor Income		Current Account	
	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP	Millions A$1970	% GDP
1950-54	470.5	9.9	519.9	10.9	8.7	0.2	-58.1	-1.3
1955-59	565.9	9.9	597.6	10.5	16.9	0.3	-48.6	-0.9
1960-64	708.9	10.8	734.6	11.2	36.6	0.6	-62.3	-1.0
1965-69	904.8	11.1	746.2	9.2	94.5	1.2	64.1	0.8
1970-74	788.1	8.4	807.4	8.6	96.2	1.0	-115.5	-1.2
1975-79	1110.6	10.6	883.7	8.5	108.0	1.0	118.8	1.1
1980-84	1374.8	13.2	1217.3	11.7	545.3	5.2	-387.8	-3.7
1975	737.4	7.3	907.1	9.0	69.5	0.7	-239.2	-2.4
1976	970.5	9.6	674.5	6.7	144.8	1.4	151.2	1.5
1977	1227.7	11.5	868.2	8.1	122.0	1.1	237.5	2.2
1978	1322.5	12.8	783.7	7.6	108.4	1.0	430.4	4.2
1979	1294.8	11.7	1185.2	10.7	95.4	0.9	14.2	0.1
1980	1242.1	11.2	1692.9	15.2	111.9	1.0	-562.7	-5.1
1981	1340.3	12.9	1628.1	15.6	282.2	2.7	-570.0	-5.5
1982	1359.1	13.8	942.9	9.5	697.6	7.1	-281.4	-2.9
1983	1476.1	14.5	898.5	8.8	824.9	8.1	-247.3	-2.4
1984	1457.8	14.0	924.3	8.9	810.1	7.8	-276.6	-2.6

Source:
Central Bank of Argentina.

TABLE 6. ARGENTINA. BALANCE OF PAYMENTS: CURRENT ACCOUNT
(Millions of US Dollars)

	Exports FOB	Imports FOB	Trade Balance FOB	Trade Balance Goods and NFS	Interest Payments	Current Account Balance
1960-64	1206	-1084	122			-153
1965-69	1506	-1091	415		-157	395
1970-74	2530	-2006	524		-308	90
1975-79	5348	-3913	1435		-616	390
1980-84	8145	-6213	1932		-4214	-3311
1975	2961	-3510	-549	-814	-430	-1284
1976	3916	-2744	1172	1155	-493	650
1977	5652	-3798	1854	1877	-569	1290
1978	6400	-3489	2911	2466	-681	1833
1979	7810	-6026	1784	348	-907	-537
1980	8021	-9394	-1373	-3259	-1531	-4767
1981	9143	-8391	752	-992	-3700	-4714
1982	7624	-4858	2766	2330	-4719	-2357
1983	7710	-4168	3542	2811	-5408	-2571
1984	8100	-4253	3847	3567	-5712	-2145

Source:
Central Bank of Argentina.

TABLE 7. ARGENTINA. BALANCE OF PAYMENTS: CAPITAL TRANSACTION
(Millions of US dollars)

	Current Account Balance (1)	Change in Reserves* (2)	Change in Foreign Debt (3)	Residual** (4)= (1)+(2)+(3)
1975	-1284	723	2571	2010
1976	650	-1154	195	-309
1977	1290	-2090	1398	598
1978	1833	-1966	2818	2685
1979	-537	-4310	6538	1691
1980	-4767	2850	8128	6211
1981	-4714	3569	8509	7364
1982	-2357	706	7963	6312
1983	-2571	-192	2372	-391
1984	-2154	-254	1815	-593
Accumulated				
1975--79	1952	-8797	13520	6675
1980--84	-16563	6679	28787	18903
1975--84	-14581	-2118	42307	25608

* A minus sign indicates an increase in reserves. These are gross foreign assets (including gold) held by the Central Bank.

** Even though the deficit in the current account may be underestimated and the direct foreign investment is not considered, this residual is a good indicator of the accumulation of foreign assets by residents, except the Central Bank.

Source:
Central Bank of Argentina.

TABLE 8. ARGENTINA. FOREIGN DEBT
(Millions of US Dollars)

	GDP in US Dollars Official Exchange Rate	Parity Exchange Rate*	Total Foreign Debt	Gross Reserves	Exports Mechandise	Goods and NFS	Net Interest Payments
1975	53345	42462	8085	618	2961	3704	430
1976	41574	43966	8280	1772	3916	4752	493
1977	51077	49936	9678	3862	5652	6769	569
1978	65525	52019	12496	5828	6400	7714	681
1979	107975	62392	19034	10138	7810	9601	907
1980	153997	71970	27162	7288	8021	10765	1531
1981	122956	73488	35671	3719	9143	11545	3700
1982	67074	71090	43634	3013	7624	9525	4719
1983	66861	74393	46006	3205	7710	9386	5408
1984	76233	78130	47821	3459	8100	9878	5712

	As % of GDP at Parity Rate			As % of Total Exports		
	Total Debt	Net Debt**	Interest Payments	Total Debt	Net Debt**	Interest Payments
1975	19.0	17.6	1.0	218.3	201.6	11.6
1976	18.8	14.8	1.1	174.2	137.0	10.4
1977	19.4	11.6	1.1	143.0	85.9	8.4
1978	24.0	12.8	1.3	162.0	86.4	8.8
1979	30.5	14.3	1.5	198.3	92.7	9.4
1980	37.7	27.6	2.1	252.3	184.6	14.2
1981	48.5	43.5	5.0	309.0	276.8	32.0
1982	61.4	57.1	6.6	458.1	426.5	49.5
1983	61.8	57.5	7.3	490.2	456.0	57.6
1984	61.2	56.8	7.3	484.1	449.1	57.8

* Using the parity exchange rate estimated by Carta Economica.

** Total foreign debt minus gross reserves

Source:
Central Bank of Argentina and Carta Economica.

TABLE 9. ARGENTINA. PUBLIC SECTOR EXPENDITURES AND REVENUES
(as Percent of GDP)

		1961	1965	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
I.	CURRENT REVENUES	33.5	29.3	37.0	31.4	34.5	39.0	43.6	41.2	43.6	45.5	42.2	43.9	44.0
	1. Taxes	20.3	17.8	22.9	16.4	18.6	21.5	24.1	24.1	27.3	26.2	23.0	22.9	25.1
	2. Others	13.2	11.5	14.1	15.1	15.8	17.5	19.5	17.1	16.3	19.3	19.2	21.0	18.9
II.	CURRENT EXPENDITURES	27.6	26.9	30.7	36.7	32.3	30.7	37.4	36.9	41.8	52.9	51.4	51.5	48.6
	1. Salaries	11.3	11.4	11.0	14.8	9.1	8.6	10.6	10.7	12.4	12.6	10.3	13.3	13.3
	2. Goods and Services	7.7	6.0	6.8	9.0	10.5	9.8	10.4	9.6	9.3	10.9	13.3	13.5	12.5
	3. Interest Payments	0.1	0.1	0.8	1.3	2.1	2.1	3.2	3.2	3.6	10.1	12.7	6.4	5.6
	4. Transfers	8.4	9.4	12.2	11.6	10.5	10.2	13.2	13.5	16.5	19.2	15.1	18.3	17.2
III.	SAVINGS (=I-II)	5.9	2.4	6.3	-5.3	2.2	8.3	6.2	4.3	1.8	-7.4	-9.2	-7.6	-4.6
IV.	CAPITAL REVENUES	0.5	0.5	0.5	0.5	0.4	0.8	1.3	0.8	0.8	1.4	1.4	1.2	1.1
V.	CAPITAL OUTLAYS	10.2	5.7	8.8	10.8	13.2	14.1	14.2	11.7	11.2	12.0	10.9	11.4	10.3
VI.	TOTAL REVENUES (=I+IV)	34.0	29.8	37.5	31.9	34.9	39.8	44.9	42.0	44.4	47.0	43.6	45.1	45.1
VII.	TOTAL EXPENDITURES (=II+V)	37.8	32.7	39.5	47.5	45.4	44.8	51.6	48.7	52.9	64.9	62.4	62.9	58.9
VIII.	BALANCE (=VI-VII)	-3.8	-2.9	-2.0	-15.6	-10.6	-5.0	-6.7	-6.7	-8.6	-18.0	-18.8	-17.8	-13.8
FINANCING														
IX.	CENTRAL BANK	0.3	0.7	0.6	8.3	3.5	1.5	0.0	0.0	3.4	5.1	4.8	16.6	6.1
X.	DOMESTIC CREDIT	1.6	-0.2	-0.3	2.7	2.9	1.7	4.0	3.1	1.4	3.8	5.3	-0.3	0.0
XI.	FOREIGN CREDIT	0.4	0.4	0.7	0.2	1.1	1.4	2.2	1.5	1.2	6.8	3.4	0.0	0.1
XII.	OTHER FUNDS	1.5	1.9	1.1	4.4	3.1	0.5	0.5	2.1	2.5	2.3	5.2	1.4	7.6

Source:
Prepared with data from M.A. Broda y Asociados.

TABLE 10. PUBLIC SECTOR EXPENDITURE AND REVENUES, 1984 AND 1985
(as Percent of GDP)

	Central Government		Provinces and Municipalities		Social Security System		Enterprises and Entities		Total Public Sector	
	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985
I. CURRENT REVENUES	12.5	13.8	7.6	8.3	9.4	9.2	14.4	16.7	44.0	48.0
1. Taxes	10.0	11.4	6.3	6.7	8.8	8.7	0.0	0.0	25.1	26.9
2. Otheres	2.5	2.4	1.3	1.6	0.6	0.5	14.4	16.7	18.9	21.1
II. CURRENT EXPENDITURES	10.7	9.2	9.7	8.4	12.8	12.2	15.4	15.3	48.6	45.1
1. Salaries	3.7	3.0	5.7	4.9	0.4	0.4	3.5	3.0	13.3	11.3
2. Goods and Services	2.0	1.7	1.4	1.4	0.0	0.0	9.1	9.1	12.5	12.2
3. Interest Payments	3.1	2.7	0.1	0.0	0.0	0.0	2.5	2.7	5.6	5.4
4. Transfers	1.9	1.8	2.5	2.0	12.4	11.8	0.4	0.5	17.2	16.2
III. SAVINGS (=I-II)	1.8	4.6	-2.1	-0.1	-3.3	-3.0	-1.0	-1.4	-4.6	2.9
IV. CAPITAL REVENUES	0.0	0.0	0.2	0.1	0.4	0.4	0.5	0.5	1.1	1.0
V. CAPITAL OUTLAYS	1.7	1.6	3.5	3.3	0.2	0.2	4.9	3.9	10.3	9.0
VI. TOTAL REVENUES (=I+IV)	12.5	13.8	7.8	8.4	9.8	9.6	15.0	17.2	45.1	49.0
VII. TOTAL EXPENDITURES (=II+V)	12.4	10.7	13.3	11.7	13.0	12.5	20.3	19.2	58.9	54.1
VIII. BALANCE (=VI-VII)	0.1	3.1	-5.5	-3.3	-3.2	-2.9	-5.3	-2.0	-13.8	-5.1

Note:
The estimates for 1985 are based on the Budget approved in September 1985 and assume a decline of 2.5% in GDP.

TABLE 11. ARGENTINA. RELATIVE PRICES AND REAL WAGES
(1970=100)

	Real Exchange Rate (1)	Agricultural Prices (2)	Import Prices (3)	Real Wages (4)
1970	100.00	100.00	100.00	100.00
1971	88.50	108.43	90.03	100.65
1972	102.22	126.33	108.05	95.60
1973	75.67	88.77	98.28	100.08
1974	69.84	104.26	126.76	110.50
1975	78.72	82.74	146.82	106.43
1976	107.16	91.52	203.87	76.63
1977	98.47	97.69	186.76	70.85
1978	80.07	91.98	128.03	69.30
1979	59.52	90.98	97.47	78.48
1980	47.20	82.20	94.26	88.45
1981	59.86	75.11	114.46	80.68
1982	105.55	88.27	163.12	69.98
1983	111.26	91.09	154.92	87.98
1984	102.48			110.38
Average	85.77	94.24	129.49	89.73
S.D.	19.50	12.30	35.10	14.26

Notes:

(1) Estimated by Carta Economica using the GDP deflator for Argentina and the WPI for USA.
(2) Agricultural prices relative to non-agricultural domestic prices according to WPI.
(3) Import prices relative to non-agricultural domestic prices according to WPI.
(4) Estimated by Carta Economia using the size of nominal wages from IOL-Ministry of Labor.

Source:

INDEC and Carta Economia.

TABLE 12. ARGENTINA. EMPLOYMENT IN LARGE URBAN AREAS*

	Labor Force Participation %	Employment % Population	Employment 1970 =100	Unemployment Rate %	Employment in Services %
1966	44.9	42.6	92.8	5.1	55.3
1970	43.9	41.7	100.0	5.1	56.6
1974	39.3	38.1	111.4	3.0	49.7
1975	40.0	38.6	116.6	3.5	49.6
1976	38.9	37.2	110.5	4.3	51.5
1977	38.8	37.8	115.0	2.5	52.9
1978	39.5	38.7	113.5	2.0	53.3
1979	39.2	38.4	109.3	2.2	54.4
1980	39.2	38.2	117.7	2.4	53.3
1981	39.0	36.9	121.3	5.3	56.8
1982	39.2	37.5	123.2	4.3	61.3
1983	38.0	36.6	122.5	3.8	60.7
1984	38.6	36.6	124.9	5.3	59.5

*Greater Buenos Aires, Greater Cordoba, Greater Rosario, Mendoza and Tucuman.

Source:
INDEC.

TABLE 13. ARGENTINA. MARGINAL PRODUCTIVITY OF CAPITAL
(Five Year Averages)

	Investment in Fixed Capital as % GDP		Change in GDP per Unit of Investment	
	Gross	Net	Gross	Net
1950-54	15.9	5.1	0.13	0.41
1955-59	16.1	6.4	0.18	0.46
1960-64	19.9	10.3	0.21	0.41
1965-69	18.9	9.3	0.27	0.54
1970-74	20.8	11.0	0.12	0.23
1975-79	21.7	11.9	0.08	0.15
1980-84	17.0	6.8	-0.07	-0.16

Source:
M.A. Broda and J.C. de Pablo « Por los Carriles Tradicionales la Argentina Esta Condenada al Estancamiento Absoluto por Muchos Anos. Pero Hay Salidas » , Serie Seminarios, Instituto Torcuato Di Tella, November 1985.

TABLE 14. ARGENTINA. MONETARY AGGREGATES AND INTEREST RATES

	M1	M2	M3	M4	Real Interest Rates % Annual Deposits	Loans
	as percent of GDP					
1950-54	25.23	33.53	33.53	33.53		
1955-59	21.26	28.13	28.13	28.13		
1960-64	13.99	18.96	18.96	18.96		
1965-69	12.74	19.91	19.91	19.91		
1970-74	12.83	22.83	24.14	24.18		
1975-79	7.29	16.65	17.48	19.89		
1980-84	4.88	17.38	17.49	20.04		
1975	10.13	16.30	17.98	19.05	-72.36	-68.57
1976	7.27	10.50	11.75	14.63	-65.14	-65.04
1977	6.79	15.24	16.32	19.30	-19.78	-0.66
1978	6.32	20.05	20.14	22.81	-14.61	11.92
1979	5.94	21.17	21.20	23.66	-9.43	2.58
1980	6.43	24.53	24.56	26.71	-4.38	25.91
1981	5.17	22.57	22.58	25.52	9.51	7.03
1982	5.03	19.31	19.31	22.34	-15.13	-12.42
1983	4.02	11.34	11.35	13.75	-9.56	-18.44
1984	3.74	9.16	9.67	11.90		

Notes:

M1 = Currency + demand deposits.
M2 = M1 + Savings and time deposits.
M3 = M2 + non-regulated deposits + acceptances.
M4 = M3 + Treasury's Indexed Bonds (VNA) + Treasury's Bills + Mortgage Bonds + Indexed Long-Term Deposits + Dollar Deposits.

Sources:

Prepared with data from M.A. Broda y Asociados. Interest rates from World Bank « Argentina Economic Memorandum », 1985, p. 205.

TABLE 15. ARGENTINA: ECONOMIC INDICATORS

	Unit	Year 1983	Year 1984	1984 Dic.	1985 Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.
NATIONAL ACCOUNTS													
GDP, total	1970=100	116.4	119.2			114.0			114.3				
GDP, agriculture	1970=100	136.3	141.3			139.5			136.8				
GDP, manufacture	1970=100	113.3	117.8			99.0			107.7				
Consumption	1970=100	122.4	130.2			127.4			117.4				
Investment	1970=100	81.4	70.5			57.6			62.7				
Industrial production	1970=100	104.1	108.6	100.9	101.4	97.3	104.7	100.2	101.5	94.4	91.7	94.4	
PRICES													
Wholesale prices	% change period	360.9	573.3	23.2	21.1	17.8	27.7	31.5	31.2	42.3	-0.9	1.5	0.6
Consumer prices	% change period	343.8	626.7	19.7	25.1	20.7	26.5	29.5	25.1	30.5	6.2	3.1	2.0
REAL WAGES													
Manufacture	1982=100	124.7	150.4	152.1	143.5	133.7	132.3	132.1	134.9	128.1	120.6	111.5	109.3
Construction	1982=100	146.0	178.5	159.3	139.7	133.0	132.3	127.0	128.6	120.8	113.7	110.7	108.5
Public sector	1982=100	94.9	106.6	96.8	93.4	88.7	85.1	81.4	82.3	77.3	77.8	70.6	69.2
EXCHANGE RATE													
Official exchange rate	% change period	377.3	545.7	20.5	25.1	20.6	26.3	29.4	32.4	40.2	8.8	0.0	0.0
Spread Parallel/official	%	40.6	31.3	13.1	19.3	30.8	31.6	29.6	18.1	9.2	18.6	19.3	17.4
Spread official/parity	%	11.3	2.5	10.0	13.2	14.8	13.2	12.9	13.8	16.9	25.7	23.0	21.0
TRADE													
Exports	Millions US$	7836	8102	476	626	531	647	829	806	934	830	740	
Imports	Millions US$	4504	4581	424	373	265	335	342	333	249	350	320	
Trade balance	Millions US$	3332	3521	62	353	266	312	487	473	685	480	420	
PUBLIC SECTOR													
Revenues, real	Thousands A$1982	9265	9520	734	696	442	638	800	669	1331	1514	1477	
Expenditures, real	Thousands A$1982	22418	17412	1506	1263	1450	1312	2020	1623	1770	1566	1497	1451
Revenues/expenditures	%	41.3	48.9	55.5	58.1	48.0	33.7	31.6	49.3	27.4	85.0	101.1	101.8
Real Prices													
Of State Products	1982=100	109.2	127.5	136.6	136.0	131.4	128.6	124.8	135.2	146.9	154.3	150.7	148.9
Of Petroleum	1982=100	121.5	152.5	160.9	160.8	155.1	151.7	145.1	158.4	171.5	180.0	175.8	173.7
MONEY AND INTEREST													
Monetary base, average	Millions A$	87	489	935	1142	1292	1391	1478	1356	1952	2795	3071	3286
Monetary base, average, real	1982=100	112.0	86.4	72.2	72.5	69.1	58.7	48.2	40.3	41.3	60.0	64.4	68.1
M2, average	Millions A$	84	505	1048	1276	1506	1781	2091	2605	3759	4817	4931	5190
M2, average, real	1982=100	75.1	62.8	58.8	58.8	58.0	53.4	59.2	57.1	60.3	75.9	78.9	
Loan interest rates													
regulated	% per month	12.6	15.6	19.0	20.0	20.0	22.0	28.0	32.0	17.2	5.0	5.0	
Free	% per month	18.7	18.8	33.2	25.2	22.9	25.5	27.4	31.1	18.8	7.2	5.5	

Source:
Carta Economica.

→ D-2D (Ag)

October 27,1985

THE ARGENTINE STABILIZATION: A PROGRESS REPORTT

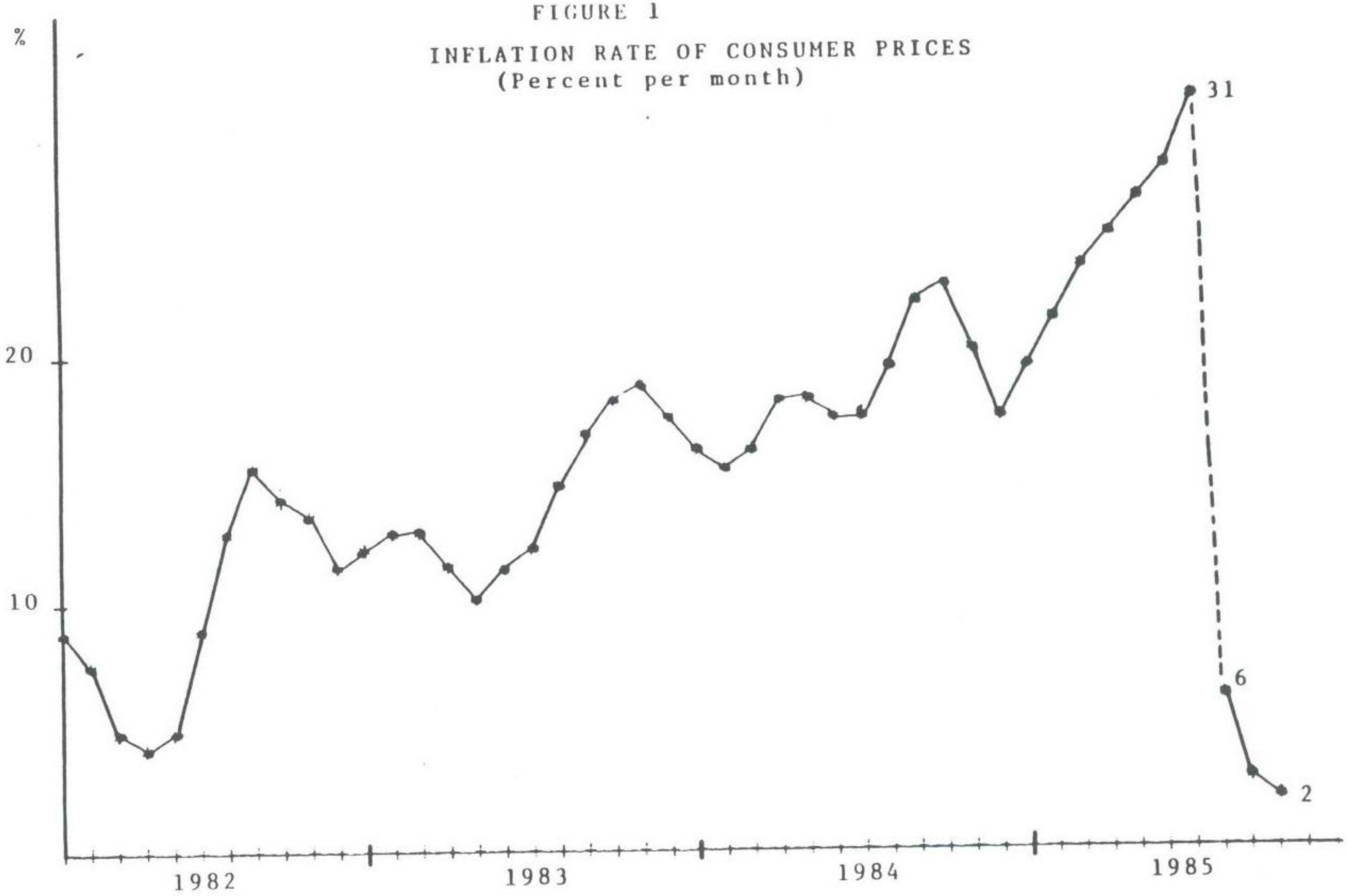
Rudiger Dornbusch
Massachusetts Institute of Technology

It is difficult to date Argentina's decline. Conservatives place it in 1916 when Hipolito Yrigoyen assumed the presidency, others go to Peron in 1946-55, or to Peronism in 1973-76. But nobody really doubts that Argentina has been going downhill for as long as anyone can remember. There have been 40 Central Bank presidents in the past 40 years, countless finance ministers and even more stabilisation programs than military coups. Income per capita today is less than it was 15 years ago and emigration of educated people is proceeding at an alarming rate. The country has become a betting parlor where going short on the home currency is considered an honest day's work. Argentinians are thought to hold as much as $US 30 billion in money abroad and another $3 billion under the mattress. Argentina demonstrates that when bad economics is practiced too long it actually puts in question the political and social viability of a country.

Alfonsin was elected in Fall 1983 in a landslide vote for stability. But to start with, things went wrong: There was little growth and the inflation rate exploded,as shown in Figure 1, from only 250 percent per year at the time he took office to well above 2000 percent this spring. Inflation became the most important issue. Having put the country on the verge of hyperinflation Alfonsin faced the prospect of losing in the upcoming Congressional elections and worse, bringing back the military who are always looking for a chance of being in office rather than in jail.

FIGURE 1

INFLATION RATE OF CONSUMER PRICES
(Percent per month)



The Plan of June 1985

Until June the government had tried to stabilize the economy using gradualism. But the result of high real interest rates was a sharp slide of industrial production and no brake to the accelerating inflation. Table 1 shows key macroeconomic data for Argentina since 1982. The table helps place in perspective the stabilization task.

Table 1 Macroeconomic Indicators for Argentina

	1982	1983	1984	1985							
				I	II	III	M	J	J	A	S
Real GDP	89	92	93	95							
Industrial Prod.	80	88	91	85	83	89	85	79	77	81	84
Real Wage	80	100	120	136	131	112	138	123	115	112	109
Parallel $	61	41	31	27	19	19	18	8	18	19	19
Budget Deficit		12	11	11	12.5	2.0*					
Inflation	187	380	659				25	31	6	3	2
Real Interest Rate	0.2	3.1	1.1	1.7	-5.4	5.7	2.6	-14.8	5.8	5.2	6.0

*Target
Notes: Real GDP, Index 1980=100; Ind. Production, 1980=100; Real Wage, Index 1983 =100; Real Monetary Base, Index 1983 =100; Parallel Dollar Premium, percent of Official Rate; Budget Deficit, including Central Bank, percent of GDP; Inflation Rate of the CPI, annua rate except for 1985 where monthly rate is given; Real effective interest rate, percent per month, using WPI as deflator.

The loss of confidence in gradualist policy, and an unwillingness to accept IMF austerity per se, led to the conception of the Austral Plan. The plan strikes an ingenious balance between the fundamentals: monetary and fiscal austerity and pragmatism that is absent from IMF-style programs. The pragmatism resided in the adoption of wage-price controls as the central feature of the disinflation program. Here are the key features of the plan:

1. The implementation of the plan is preceded by an increase in public sector prices and a sharp devaluation. Export tariffs are imposed and import duties.

2. Wage-price controls are imposed until further notice.

3. The government undertakes not to emit any money to finance the treasury. The budget deficit is to be cut down by tax and spending measures.

4. A tablita is announced to adjust outstanding loan contracts for the immediate and unanticipated cessation of inflation.

5. A new money is introduced--the Austral-- and the new currency is fixed to the dollar at 0.8 Australs (also called Penguins) to the $U.S. The old money is maintained and continues circulating, some of it being stamped with the new Autral symbol.

6. The program is accepted by the IMF and rescheduling negotiation with the creditor banks is started.

It is worth asking at the outset where the ideas for the plan came from. There is little question that the economic team -- Sourrouille, Brodersohn, Canitrot and Machinea-- are the principal architects. But what is particularly interesting is the extraordinary care and attention for historical experiences that went into the design of the plan. It is certainly the case that in April studies were well advanced to the point of being concerned with the precise measures that were taken in hyperinflation stabilisation programs. The authors became intimately familiar with the experiences in Europe in the 1920s, especially the stabilisation of the German hyperinflation.

Not surprisingly most of the features of the plan can be traced to the successful German experiment, and much less to recent ideas from Latin America or elsewhere. In particular the idea of controlling the disinflation via exchange rate fixing had been a key feature of the German program. But the Argentinians, remembering the catastrophic experience under Martinez de Hoz rightly supplemented fixed exchange rates with incomes policy-- control of wages and prices. In fact the team had been most sceptical about price controls because no formal control apparatus was available or could be set up at short notice. Perhaps that also was good luck because, as it turns out, the fact that prices have some possibility of adjustment removes the threat of shortages or a catch-up explosion once the control policy is abandoned.

In only three months the desperate outlook has changed completely. Most impressive, the opinion polls show a near 80 percent approval rating for the policies, foreshadowing yet another landslide victory in November and with it a real chance to cement the stabilisation and to put Argentina back on her feet.

Of course, it is much too early to predict ultimate success. So far much of the stabilisation remains provisional and the most difficult choices lie ahead. The budget stabilisation was achieved by increasing sharply all public sector prices and by raising tariffs on exports and imports. These measures raised revenues and the freeze on prices helped increase the real tax collection by eliminating the inflationary erosion of the tax yield between the time taxes are assessed and the time they are actually collected. If tax collection is delayed by one month and the inflation rate is, say 30 percent, then of course the real tax revernue, by the time it gets to the treasury is worth only 70 percent of what it should be. Just as in the German experience of the 1920s this proved a critical ingredient in early success for Argentina. Real wages have been cut by more than 20 percent since last year. All these measures explain how the deficit in the public accounts that was about 12 percent of GDP in early 1985 is expected to decline to only 2.0 percent by next year.

Problems Ahead

Over the next six month the stabilisation program faces three key challenges. The first is that much of the emergency taxation, in particular export taxes, must come off. Table 2 shows the budget data for 1983-4 and the 1985 perspective.

Table 2 The Public Sector Budget Deficit (Percent of GDP)

	1983	1984	1985		
			Year	1st	2nd Half
Public Sector:					
Revenue	21.7	22.5	25.3	21.5	27.2
Expenditure	32.1	30.7	28.8	29.0	28.5
Deficit	10.4	8.2	3.5	7.5	1.3
Consolidated Deficit*	11.5	10.9	6.0	12.0	2.5

*Including operations of the Central Bank

Export taxes on agricultural goods have long financed the entire economy, but they do so to the detriment of productivity, growth and foreign exchange revenue. Regular taxation, levied on a broad base such as wealth must replace the ad hoc taxes that now fill the big budget gap. The November elections provide a unique opportunity to undertake that indispensable step. Without a broad-based tax that routinely finances the budget and dispenses with the need for printing money stabilisation might last a year or two but must ultimately collapse again.

In the context of taxation it is important to see what a terrible havoc international capital mobility and inflation have played with the government's ability to finance part of the deficit by revenue from money creation. Capital flight has eroded the tax base in respect to income from capital and substitution toward the dollar has eroded the ratio of government money to GDP. Fiscal reform must therefore restore more normal conditions in both respects. The government should most forcefully restore its seignorage by abolishing and effectively prohibiting money substitutes. There is, indeed, some cost and loss in efficiency but there are gains. Surely it must be recognized that the government must finance its budget either by taxes or by inflation. A much more restricted provision of money substitutes means a much broader base for seignorage from inflation and growth in real balances and hence the need for less onerous tax rates for those who do pay taxes.

The same goes for an effective prosecution of those who have placesd assets abroad and are thus avoiding national taxation. Their capital flight means that there is more inflation or higher tax rates for those who were unable to get their money out. Measures to avoid capital flight and enforce equitable tax performance are entirely within the scope of a serious, non-corrupt and democratic government.

The second problem is the real interest rate. Because the government has undertaken not to print <u>any</u> money the real money stock is still at its hyperinflation low and hence interest rates are extremely high. The real lending rate is in the range of 40 to 60 percent. That is a serious problem because the cost of credit exceeds the profitability of investments thus leading to accumulation of bad debts, a deterioration of financial stability and a decline in activity. If the high real rate persists there will inevitably have to come inflationary liquidation, as in 1982, or outright write-offs. The government sees no way out: money cannot be printed except by monetizing capital inflows. But Argentinians have been shy to move their money back and there is no serious chance that repatriation of capital will solve the problem. The government must, of course, be careful not to prejudice its credibility but it also cannot afford the high real rates. Some money will have to be printed soon.

The high real interest rate poses an immensely difficult challenge for the authorities. Table 3 helps understand what is at issue. The Table shows the levels of the monetary aggregates and the cumulative percentage increase since June. Considering the fact of a fixed exchange rate and wage-price controls an increase in the money stock of 70 to 80 percent seems entirely out of line with a credible disinflation policy. One might be tempted to think that the program must collapse within short time.

Table 3 The Behavior of the Monetary Aggregates
(Million Australes)

	Base	M_1	M_4
May	1355	927	3445
June	1950	1630	4877
July	2792	2589	6546
August	3070	2811	7393
September	3293	3010	8206
% Change June-Sept.	69%	85%	68%

But that would be a misunderstanding of the monetary economics of stabilisation. Figure 2 shows why. The real monetary base declined during the period of escalating inflation. In that period rapid growth of money and was outpaced by even faster growth of prices. But when the stabilisation took place the free dynamics of money and prices changed: the fixed exchange rate, fixed public sector prices and wage-price control substantially froze the level of prices. The commitment not to emit money froze the monetary base except for the possibility of foreign exchange inflows through foreign borrowing or repatriation of Argentine assets abroad.

Under these conditions the real monetary base was the same the day before and the day after the reform and so was the nominal interest rate. But the disappearance of inflation implied that the real interest rate now was sky-high. Moreover it would remain unless the government found a way of expanding the money stock. But, of course, expanding the money stock involves the risk of a loss in credibility, collapse of the parallel market and hence a resurgence of inflation. The high real interest rates are equally threatening. They imply that debts are rolled into mountains of

FIGURE 2

THE REAL MONETARY BASE
(Index 1983=100)

claims much larger than the underlying value of productive assets. As a result claims of the financial sector will turn bad and finally the sebts will have to be written off or inflated away. The government therefore must find a middle course betweeen the losses two ways of loosing credibility--to much and too little credit expansion.

The German precedent is relevant here,too. The critical point is the distinction between monetary conditions measured by the level of the real money stock and by real interest on one hand and the growth rate of money on the other. Even though money growth rates can be extremely high, money remains terribly tight. In Germany the real money stock had declined even further than in Argentina. Once monetary reform got underway, with a fixed exchange rate, exactly the same problem emerged. The disappearance of inflation turned the given nominal interest rate that had been perfectly reasonable during high inflation into an extraordinarily large real rate.In fact, in the first two months following stabilisation the real rate of interest exceeded 1 percent per day.

Even four months after stabilisation the nominal rate was still more than 50 percent per year. But in the German case the government,while committed not to finance the Treasury, did expand private credit at a very rapid rate, particularly in the immediate period following stabilisation. In the first four months following stabilisation the money stock expanded by 200 percent. Over the same period the price level fell by nearly 20 percent and the parallel exchange rate declined by far more. The point then is that money can afford to expand without creating inflation. But the limits are precarious. When the German government at one point overdid the expansion the exchange rate moved toward depreciation and a resumption of even tighter money was necessary to maintain the stance of disinflation.

The policy prescription for Argentina would therefore seem to be the following: to pursue a policy that agressively expands monetary aggregates by private credit, subject to the provision that when the parallel market turns markedly the expansion is immediately stopped. There is no irreparable harm that comes from trying, day after day, to liquify the economy to the largest extent possible. Certainly nobody would argue supply side shortages are an active issue. The credit expansion is not risky because the very fact that there is no effective price control system assures that inflation pressure is quite open in goods prices and the parallel market. So far inflation is still coming down and parallel market, if anything suggests too little monetisation. But credibility is an issue. For that reason early fiscal reform, and hence no further need to finance the government, would free the hands for reflation through private credit.

The third issue is how to abandon wage-price controls without a resurgence of inflation. Clearly these controls will have to go before major shortages become a political headache. But when prices are liberalized the problem is to lock in the cut in real wages that has already been achieved. Perhaps the only chance is to liberalize imports and use effective import competition to check price increases. That is a very risky strategy because it may cost employment and scarce foreign exchange. But a renewed burst of inflation and strikes to get a restoration of real wages are a much worse prospect.

Of course, import liberalisation and a fixed exchange rate in the face of ongoing inflation-- cumulatively 11 percent since June-- are a very touchy issue in Argentina. The experiment of disinflation under Martinez de Hoz left the country in a mess and is doubtful that any policy maker is very eager to renew the experiment. But there is an important difference. The competitive position of Argentina has, indeed, been improved over the last year. Especially the devaluation preceding the stabilisation created room for <u>some</u> erosion. Removal of export taxes are a vehicle for improving competitiveness without the need to move the exchange rate. The target of zero wage increases and zero currency depreciation should remain the paramount objective of policy. The budget and trade taxes, and stabilisation loans that allow increased imports in areas that do not hurt employment but foster cost reductions, should be the vehicles for this stance of price stability.

<u>The Outlook</u>

With these nasty problems ahead why should this program not fail just as earlier one always have? The argument is entirely political. Alfonsin has achieved a historic support,and is changing Argentine politics by splitting Peronism into two. The Frente de la Renovacion (the progressive and socially responsible wing) of Peronism is now practically supporting Alfonsin even as they are trying to reshape the movement. These Peronists see themselves in the same position as post-Mondale Democrats in The U.S., recognizing that the game has changed completely and that the future is in the middle of the road, with new ideas and under new management. A mark of the support for Alfonsin is the complete failure of the the unions to bring out a general strike last August. It simply was a flop. Of course that is not to say politics are easy. The right-wing is up in terrorism to stop the land slide. But one must hope and can even expect that the broadly-shared gains from stability, and the prospect of a longterm improvement in Argentina's economic and social viability will carry the day and give Alfonsin the mandate for prosperity with democracy.

So far Alfonsin has shown a brilliant sense of strategy: by putting the military in jail, by waiting for the verge of hyperinflation before embarking on stabilisation and by using wage-price controls to complement fiercely orthodox monetary restraint. But there is an urgency now to move ahead,exploit the success and shape events rather than be carried by them. He needs to produce at least one good piece of news every month: liberalizing the economy, cutting down the inefficient public sector and instituting a broad-based, effective tax system. There is urgency because if he misses this one, Argentina won't get another chance for years.

Economic stabilisation in Europe the 1920s and 1940s took place with the aid of stabilisation loans from abroad. In the 1920s the League of Nations, the U.S., and private capital markets provided the help. In the 1940s the U.S., through the Marshall Plan aided reconstruction while Europe used regional compensation and trade restriction to cope with the dollar shortage. In the aftermath of the international debt crisis today the private capital market is far from rushing in with stabilisation loans. On the contrary, debt servicing is perhaps the major part of the adjustment difficulty. The major industrialized countries have so far found it preferable to stand on the side of the creditor banks, enforcing austerity and debt service rather than efficient adjustment.

But there is some hope in the new pragmatic approach of the U.S. Treasury. While still recognizing debt service as the basic premise there is a recognition now that recycling must take larger proportions via increased flows of "new money" and enhanced involvement of the World Bank, focussing on growth rather than depressive IMF-style policies. Recycling of debt service is essential because without it there will be yet more years without investment which will yet further deteriorate the ability of the economy to provide jobs and pay taxes.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

→ Argentina RB.

DATE: January 22, 1986

TO: Mr. C. Obidegwu, EPDCO

FROM: Nicholas Carter, LC2DR

EXTENSION: 72013

SUBJECT: Argentina Projections

1. Thank you for your observations and suggestions on the projections that were made for the Argentina debt workout paper. I appreciate the care with which you checked the model and the data.

2. The export category "other goods" represents a group of semi-manufactures, mainly of agricultural origin. For this reason, I used the Food Price Index from the EPD projections. This index is shown at the bottom of the first page of the printout of the model. The figure for 1991 was, in fact, a typo, and the result of correcting it is to improve slightly the performance of the balance of payments in the base case during the 1990s. The corrected "real index" is now shown in the attached tables; you should ignore the manufactures line under the "real index" as manufactures use the MUV directly. In addition, the lines labelled "MELAS" should be interpreted with caution; they are ex ante elasticities which have been overridden in 1985 and 1986 by IMF estimates, and in the high case by specific additions to import amounts.

3. Finally, a question was asked about the difference between public savings and public investment. In addition to the definitional problems that arise between fiscal and national income accounts, it should be noted that the figures on saving are domestic and thus a substantial portion of public savings in the early years is devoted to debt repayment. In the later years there is correspondingly an implicit use of public savings by the private sector.

4. I hope this clears up any questions you might have. I would be happy to discuss with you any further problems with the model or with the data.

Attachment

cc: Messrs. Sokol
Choksi
Rajapatirana
Armington

NCarter:pb

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP	51254	49705	51022	52814	54544	56366	58175	60072	62038	64126	66300
Investment	7391	6278	6690	7120	7588	8085	8612	9159	9742	10366	11031
-Public	2607	2451	2426	2523	2624	2729	2839	2952	3070	3193	3321
-Private	4784	3827	4264	4596	4964	5356	5774	6207	6672	7173	7711
Exports	6710	7489	7262	7745	7976	8245	8441	8695	8953	9269	9601
Imports	4529	4288	4494	4665	4835	5014	5198	5406	5625	5856	6098
Consumption	41682	40226	41564	42615	43815	45050	46320	47625	48967	50347	51766
Population	29789	30325	30871	31427	31992	32568	33155	33751	34359	34977	35607
C per capita	1399	1327	1346	1356	1370	1383	1397	1411	1425	1439	1454
exch rate(bs)	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765
CPC ($)	2068	1961	1990	2004	2024	2045	2065	2086	2107	2128	2149
YPC($)	2543	2423	2443	2484	2520	2558	2594	2631	2669	2710	2752
Dom.Savings	9572	9479	9458	10200	10729	11316	11856	12447	13071	13779	14534
FIP	-3859	-3651	-3467	-3352	-3046	-3013	-2849	-2604	-2526	-2393	-2245
GNP	47395	46054	47555	49462	51498	53353	55326	57468	59512	61733	64055
GNP per cap	1591	1519	1540	1574	1610	1638	1669	1703	1732	1765	1799
GNS	5713	5828	5991	6848	7683	8303	9007	9843	10545	11386	12289
ExportsGNFS	9856	10202	9939	11455	12862	14537	16275	17518	18842	20370	22029
Goods	8100	8400	8109	9418	10585	11987	13421	14416	15472	16707	18048
NFS	1756	1802	1830	2036	2277	2550	2854	3101	3371	3663	3981
ImportsGNFS	6639	6127	6795	7517	8345	9291	10331	11217	12181	13236	14387
Goods	4600	4049	4649	5140	5705	6353	7062	7647	8283	8980	9739
NFS	2039	2078	2146	2376	2640	2938	3269	3569	3898	4257	4648
Res.Balance	3217	4075	3144	3938	4517	5246	5944	6301	6661	7134	7641
Imports											
Food/Cons	239	162	175	205	241	285	335	358	381	407	434
Petroleum	507	432	403	409	415	420	425	456	489	525	564
Int'medite	3254	3041	3581	3966	4403	4902	5442	5872	6337	6845	7396
Capital	600	414	489	560	646	746	860	961	1075	1202	1345
NFS	2039	2078	2146	2376	2640	2938	3269	3569	3898	4257	4648
G&NFS	6639	6127	6795	7517	8345	9291	10331	11217	12181	13236	14387
Constant											
Food/Cons	226.4	180	185	189.21	194.01	198.93	203.97	209.15	214.45	219.89	225.47
Petroleum	484	425	441	456.49	471.45	487.19	502.83	519.23	536.21	554.26	573.05
Int'medite	3193.8	3000	3300	3415.9	3527.8	3645.7	3762.7	3885.4	4012.5	4147.5	4288.1
Capital	796.7	553	610	653.09	700.38	750.85	804.68	860.85	921.19	986.01	1055.7
NFS	2080	2126.9	2051.6	2123.7	2194.3	2267.1	2344.8	2450.3	2560.6	2675.8	2796.2
G&NFS	6780.9	6284.9	6587.6	6838.4	7087.9	7349.7	7619	7924.9	8244.9	8583.5	8938.5
Prices											
Food/Cons	1.06	0.90	0.95	1.08	1.24	1.43	1.64	1.71	1.78	1.85	1.92
Petroleum	1.05	1.02	0.91	0.90	0.88	0.86	0.85	0.88	0.91	0.95	0.98
Int'medite	1.02	1.01	1.09	1.16	1.25	1.34	1.45	1.51	1.58	1.65	1.72
Capital	0.75	0.75	0.80	0.86	0.92	0.99	1.07	1.12	1.17	1.22	1.27
NFS	0.98	0.98	1.05	1.12	1.20	1.30	1.39	1.46	1.52	1.59	1.66
G&NFS	0.98	0.97	1.03	1.10	1.18	1.26	1.36	1.42	1.48	1.54	1.61
MUV Index	98.2	97.7	104.6	111.9	120.3	129.6	139.4	145.67	152.23	159.08	166.24
FOOD Index	88	75	79	90.3	103.7	119.3	137.1	142.5	148.2	154.1	160.3

Exports-Value											
Beef	232	225	217	249	288	332	384	414	447	483	521
Wheat	1178	1241	933	1082	1170	1296	1258	1263	1277	1386	1507
Corn	760	756	914	1162	1268	1389	1531	1627	1729	1839	1957
Petroleum	446	460	409	465	490	518	546	593	643	698	758
Oils	945	945	967	1062	1172	1297	1432	1549	1675	1812	1960
OilSeeds	624	481	465	596	657	729	806	849	895	942	992
Sorghum	490	541	545	571	617	667	743	784	829	876	925
Manufactures	1622	1730	1915	2132	2395	2708	3059	3357	3683	4042	4435
Other Goods	1804	2023	1743	2099	2529	3052	3662	3980	4292	4629	4992
Total:goods	8100	8400	8109	9418	10585	11987	13421	14416	15472	16707	18048
Volumes											
Beef	217	217	219	224	228	233	237	243	249	255	262
Wheat	1184	1254	1000	1075	1072	1093	978	945	919	960	1004
Corn	725	833	1055	1237	1239	1242	1256	1277	1299	1322	1346
Petroleum	447	478	441	478	478	478	478	478	478	478	478
Oils	793	911	947	985	1025	1066	1108	1153	1199	1247	1297
OilSeeds	642	607	549	648	656	667	676	684	692	699	707
Sorghum	512	588	641	616	607	598	608	615	623	631	639
Manufactures	1540	1650	1708	1776	1856	1949	2046	2149	2256	2369	2487
Other Goods	1772	2325	1900	2014	2125	2242	2354	2460	2551	2645	2743
Total:goods	7832	8863	8460	9053	9286	9567	9742	10003	10266	10606	10963
NFS	1600	1664	1747	1835	1926	2023	2124	2219	2319	2424	2533
G&NFS	9432	10527	10208	10888	11212	11589	11865	12222	12585	13030	13495
Prices											
Beef	1.07	1.04	0.99	1.12	1.26	1.43	1.62	1.70	1.79	1.89	1.99
Wheat	0.99	0.99	0.93	1.01	1.09	1.19	1.29	1.34	1.39	1.44	1.50
Corn	1.05	0.91	0.87	0.94	1.02	1.12	1.22	1.27	1.33	1.39	1.45
Petroleum	1.00	0.96	0.93	0.97	1.03	1.08	1.14	1.24	1.35	1.46	1.59
Oils	1.19	1.04	1.02	1.08	1.14	1.22	1.29	1.34	1.40	1.45	1.51
OilSeeds	0.97	0.79	0.85	0.92	1.00	1.09	1.19	1.24	1.29	1.35	1.40
Sorghum	0.96	0.92	0.85	0.93	1.02	1.12	1.22	1.28	1.33	1.39	1.45
Manufactures	1.05	1.05	1.12	1.20	1.29	1.39	1.50	1.56	1.63	1.71	1.78
Other Goods	1.02	0.87	0.92	1.04	1.19	1.36	1.56	1.62	1.68	1.75	1.82
Total:goods	1.03	0.95	0.96	1.04	1.14	1.25	1.38	1.44	1.51	1.58	1.65
Real Prices											
Beef	231	225	201	211	222	234	246	248	250	252	254
Wheat	168	168	148	149	150	152	153	152	151	151	150
Corn	138	120	107	108	110	111	113	113	113	113	113
Petroleum	29	28.1	25.3	24.8	24.3	23.9	23.4	24.3	25.2	26.2	27.2
Oils	737	645	593	585	578	570	563	560	558	555	553
OilSeeds	287	235	235	238	241	245	248	247	246	246	245
Sorghum	121	117	101	103	105	107	109	109	109	108	108
Manufactures	98	98	105	112	120	130	139	146	152	159	166
Other Goods	104	89	88	93	99	105	112	111	111	110	109
MELAS:Food		0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Pet		1	1	1	1	1	1	1	1	1	1
INT		1	1	1	1	1	1	1	1	1	1
Cap		1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1

Ratios											
growth(GDP)		-3.02%	2.65%	3.51%	3.28%	3.34%	3.21%	3.26%	3.27%	3.37%	3.39%
I/Y	14.42%	12.63%	13.11%	13.48%	13.91%	14.34%	14.80%	15.25%	15.70%	16.16%	16.64%
Public	5.09%	4.93%	4.76%	4.78%	4.81%	4.84%	4.88%	4.91%	4.95%	4.98%	5.01%
Private	9.33%	7.70%	8.36%	8.70%	9.10%	9.50%	9.92%	10.33%	10.76%	11.19%	11.63%
ICOR		-4.77	4.77	3.73	4.12	4.17	4.47	4.54	4.66	4.66	4.77
Exp/y	13.09%	15.07%	14.23%	14.67%	14.62%	14.63%	14.51%	14.47%	14.43%	14.45%	14.48%
IMp/y	8.84%	8.63%	8.81%	8.83%	8.87%	8.90%	8.93%	9.00%	9.07%	9.13%	9.20%
TTI	1.06	0.97	0.93	0.95	0.97	0.99	1.02	1.02	1.02	1.02	1.02
Sd/y	18.68%	19.07%	18.54%	19.31%	19.67%	20.08%	20.38%	20.72%	21.07%	21.49%	21.92%
Sn/y	12.05%	12.66%	12.60%	13.84%	14.92%	15.56%	16.28%	17.13%	17.72%	18.44%	19.19%
growth Cons		-3.49%	3.33%	2.53%	2.82%	2.82%	2.82%	2.82%	2.82%	2.82%	2.82%
-Inv.pub		-5.98%	-1.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
-inv.pri		-20.00%	11.40%	7.80%	8.00%	7.90%	7.80%	7.50%	7.50%	7.50%	7.50%
-cons/pop		-5.19%	1.48%	0.73%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
-imports		-5.33%	4.82%	3.81%	3.65%	3.69%	3.66%	4.02%	4.04%	4.11%	4.14%
-exports		11.61%	-3.03%	6.66%	2.98%	3.37%	2.38%	3.01%	2.97%	3.53%	3.57%
-GNP		-2.83%	3.26%	4.01%	4.12%	3.60%	3.70%	3.87%	3.56%	3.73%	3.76%
PublicSav	6150	3430	4031	4331	4800	5073	5410	5767	6204	6541	6961
PubSav/GDP	12.00%	6.90%	7.90%	8.20%	8.80%	9.00%	9.30%	9.60%	10.00%	10.20%	10.50%
PrivateSav	3422	6049	5427	5869	5929	6243	6445	6680	6867	7238	7572
PrvSav/GDP	6.68%	12.17%	10.64%	11.11%	10.87%	11.08%	11.08%	11.12%	11.07%	11.29%	11.42%

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
ExportsGNFS	9856	10202	9939	11455	12862	14537	16275	17517	18842	20370	22029
Goods	8100	8400	8109	9418	10585	11987	13421	14416	15472	16707	18048
NFS	1756	1802	1830	2036	2277	2550	2854	3101	3371	3663	3981
ImportsGNFS	6639	6127	6795	7515	8342	9287	10328	11212	12174	13227	14376
Goods	4600	4049	4649	5138	5702	6349	7059	7642	8276	8971	9727
NFS	2039	2078	2146	2376	2640	2938	3269	3569	3898	4257	4648
Res.Balance	3217	4075	3144	3940	4520	5250	5947	6306	6668	7143	7653
FactorServices	-5705	-5369	-5456	-5644	-5514	-5874	-5976	-5709	-5674	-5604	-5478
Receipts	297	277	271	288	304	323	340	349	362	376	391
Interest	264	244	236	251	264	279	293	300	311	323	335
Other	33	33	35	38	40	44	47	49	51	53	56
Payments	6002	5646	5727	5933	5818	6197	6316	6058	6036	5980	5869
Interest	5542	5160	5224	5403	5258	5602	5680	5376	5303	5189	5013
DirectInv.	438	465	480	505	533	566	605	649	699	756	819
Other	22	22	23	25	27	29	31	33	34	36	37
Transfers	1	15	12	17	18	20	21	22	23	24	25
CurrentAcct.	-2487	-1279	-2300	-1688	-975	-604	-8	619	1017	1563	2200
DirectInvst.	269	214	246	285	330	384	447	502	564	633	711
NetM&LT-OFF	91	742	1276	630	603	308	142	32	-51	-89	-125
Disbursements	437	1077	1774	994	1034	942	871	847	821	810	815
IBRD	96	146	478	462	470	425	400	400	400	400	400
IDB	195	236	470	157	189	192	196	200	205	210	215
OthOfficial	146	695	826	375	375	325	275	247	216	200	200
Amortization	346	335	498	364	431	634	729	815	872	899	940
IBRD	80	116	149	161	159	178	198	238	247	309	334
IDB	82	76	100	35	50	68	118	134	172	171	176
OthOfficial	184	143	249	168	222	388	413	443	453	419	430
Outstd.DEBT	6476	7286	8562	9192	9795	10103	10245	10277	10226	10137	10012
IBRD	549	656	985	1286	1597	1844	2046	2208	2361	2452	2518
IDB	944	1095	1465	1587	1726	1850	1928	1994	2027	2066	2105
OthOfficial	4983	5535	6112	6319	6472	6409	6271	6075	5838	5619	5389
NetM&LT-PRV	-386	2227	883	1334	727	929	-257	-868	-1197	-1777	-2456
Disbursements	83	2992	1865	1334	727	929	209	0			
Amortization	469	765	982				466	868	1197	1777	2456
Outstd.DEBT	33633	36291	37057	38391	39118	40047	39790	38922	37726	35949	33493
NetShortTrm	-307	-1565	-505	-500	-500	-496	171	120	124	136	142
Outstd.DEBT	6570	5005	4500	4000	3500	3004	3175	3295	3419	3555	3697
TargetST	2500	2475	2506	2676	2831	3004	3175	3295	3419	3555	3697
Cap n.e.i.	2891	0	0	0	0	0	0	0	0	0	0
NetIMF	0	702	400	150	0	-300	-300	-300	-300	-300	-300
Reserve Chg.	-71	-1041	0	-211	-186	-221	-194	-105	-157	-166	-173
Res.Level	2637	3678	3678	3889	4074	4296	4489	4594	4751	4917	5091
Res/Imp	2.50	3.75	3.52	3.47	3.45	3.33	3.24	3.19	3.13	3.07	3.02
TotalDebt	46679	48582	50119	51583	52413	53154	53209	52494	51370	49641	47202
Debt/Exports	4.74	4.76	5.04	4.50	4.08	3.66	3.27	3.00	2.73	2.44	2.14
DSR	131%	110%	113%	85%	71%	64%	62%	59%	57%	56%	55%
DSR.xST	64%	61%	67%	50%	44%	43%	42%	40%	39%	39%	38%

MUV	100	99.5	106.47	113.92	122.46	131.89	141.91	148.3	154.97	161.95	169.24
Priv.Inv	4784	3827.2	4114.2	4443.4	4798.8	5182.8	5597.4	6017.2	6468.5	6953.6	7475.1
Int.rate%-FI		10.5	10.85	10.9	10.3	10.8	10.8	10.2	10.2	10.2	10.2
-WBK/IDB		9.8	10.2	10.2	9.7	10.2	10.2	9.7	9.7	9.7	9.7
Interest-OFF		635	743	873	892	999	1031	994	997	992	983
-PRV		3531	3938	4039	3954	4225	4325	4059	3970	3848	3667
-SHTRM		993	543	491	412	378	324	324	336	349	363
TOTAL		5160	5224	5403	5258	5602	5680	5376	5303	5189	5013
IntCov.Ratio	61%	83%	63%	76%	91%	99%	110%	124%	134%	147%	164%
Debt/GDP	62%	66%	62%	58%	53%	48%	44%	40%	36%	32%	28%
IMFNetPos.	1098	1800	2200	2350	2350	2050	1750	1450	1150	850	550
TotDebtincIMf	47777	50382	52319	53933	54763	55204	54959	53944	52520	50491	47752
TotDebt/GDP	63%	69%	65%	61%	55%	50%	45%	41%	37%	33%	29%
GDP(ps84)	51254	49705	51022	52814	54544	56366	58175	60072	62038	64126	66300
GDP($84)	75763	73474	75421	78070	80627	83320	85994	88799	91704	94791	98004
GDP($cur)	75763	73106	80296	88935	98737	109892	122039	131689	142117	153512	165858
GDS(ps84)	9572	9479	9458	10200	10729	11316	11856	12447	13071	13779	14534
GDS($cur)	14149	13942	14885	17176	19422	22062	24870	27287	29942	32986	36359
Interest/GDS	37%	35%	34%	30%	26%	24%	22%	19%	17%	15%	13%
Interest/GDP	7%	7%	6%	6%	5%	5%	4%	4%	4%	3%	3%
Chg.Exposure		3%	3%	3%	2%	1%	0%	-1%	-2%	-3%	-5%
FIP(real)	-5705	-5396	-5125	-4955	-4502	-4454	-4211	-3850	-3661	-3460	-3237
FIP(ps84)	-3859	-3651	-3467	-3352	-3046	-3013	-2849	-2604	-2477	-2341	-2190

	1985	1986	1987	1988	1989	1990	TOTAL
Commitments							
WORLD BANK	240	630	500	500	500	500	2870
IDB	400	400	300	200	200	200	1700
OFFICIAL-OTHER	1100	1200	900	800	800	700	5500
PRIVATE	2992	1865	1334	727	929	209	8056
TOTAL	4732	4095	3034	2227	2429	1609	18126
Disbursements							
WORLD BANK	146	478	462	470	425	400	2381
IDB	236	470	157	189	192	196	1440
OFFICIAL-OTHER	695	826	375	375	325	275	2871
PRIVATE	2992	1865	1334	727	929	209	8056
TOTAL	4069	3639	2328	1761	1871	1080	14748
NetFlows							
WORLD BANK	30	329	301	311	247	202	1420
IDB	160	370	122	139	124	78	993
OFFICIAL-OTHER	552	577	207	153	-63	-138	1288
PRIVATE	2227	883	1334	727	929	-257.3	5842.8
TOTAL	2969	2159	1964	1330	1237	-115.3	9543.8
Amortization							
WORLD BANK	116	149	161	159	178	198	961
IDB	76	100	35	50	68	118	447
OTHEROFFICIAL	143	249	168	222	388	413	1583
PRIVATE	765	982	0	0	0	466	2213.3
TOTAL	1100	1480	364	431	634	1195.3	5204.3

DOD							Change 84-90	% SHARE
WORLD BANK	579	985	1286	1597	1844	2046	1420	15%
IDB	1104	1465	1587	1726	1850	1928	993	10%
OFFICIAL-OTHER	5535	6112	6319	6472	6409	6271	1288	13%
PRIVATE	35860	37174	38391	39118	40047	39790	5842.8	61%
TOTAL	50765	51296	52730	53942	54681	55014	9543.8	100%

	1985	1986	1987	1988	1989	1990	Total85-90
BASE CASE							
CurrentDeficit	-1279	-2300	-1688	-975	-604	-8	-6854
DirectForeignIn	214	246	285	330	384	447	1906
NetOfficialSou	742	1276	630	603	308	142	3701
-WORLD BANK	30	329	301	311	247	202	1420
-IDB	160	370	122	139	124	78	993
-OTHER	552	577	207	153	-63	-138	1288
NetPrivateSour	662	378	834	227	433	-87	2447
Net IMF	702	400	150	0	-300	-300	652
Reserve Chg.	-1041	0	-211	-186	-221	-194	-1852

→ Argentina RB.

Argentina mtg: ES.

- Drop commitment tables after RC.
- Consolidate commen, disb, net flows etc.
- Drop nominal public Investment
- Show public / private I ratio.

Argentina OPSE.

- Specify the rational for the growth path chosen
  Base. on constraints.

CESW - The reasons for
- High intermediation costs in Cos. like Arg. Turkey, Brazil. Devote more resources to addressing this issue and

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Mr. Choksi

Argentina

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE December 20, 1985

TO Mr. Jose Sokol

FROM Nicholas G. Carter

EXTENSION 72013

SUBJECT Argentina Baker Initiative Paper - High Case Alternative Scenario

1. In order to test Peter Scherer's proposition that real consumption was not growing fast enough in our projections, I took another look at the high case scenario analysis. Real per capita consumption reached a peak in Argentina in 1974. In 1984 it was some 12% below that peak, with a further 4% drop projected for 1985. I, thus, tested a scenario in which that peak is again achieved in 1990. This would require per capita consumption to grow at 3.3% per year during 1986-90.

2. The results are shown in the attached tables. While the date at which excess foreign resources begin to accumulate is put off until 1991, the basic issue is that during 1986-90 GDP growth has to be in the 5.5 to 6% range in order to accommodate the required increases in consumption, while simultaneously producing goods to sustain the export drive and for the investment necessary for such production. The basic problem is that we know the Argentine economy over the past half century has never been capable of growth rates in excess of 4-4.5% over any extended period of time. In the past, the Argentines, when faced with this option, have chosen inflation and have lost out on exports. Given that we do not expect the economy's fundamental structural relationship to change significantly, even under the best of policy scenarios, there is then a clear tradeoff between the speed at which real consumption levels can be restored and the speed at which export growth can restore creditworthiness. At the point where real consumption is allowed to increase significantly, the export drive, of necessity, must lose some of its steam, with the danger that export promotion efforts may be abandoned and a return to the traditional Southern Cone import protection schemes will take place.

Attachments

cc: Messrs. Gue, Pfeffermann (o/r), Dubey, Choksi, Scherer, McCarthy, Ebiri

NGCarter:pb

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP	51254	49570	52432	55266	58516	61954	65310	68803	72407	76287	80369
Investment	7391	6304	6860	7466	8206	8958	9710	10449	11178	11961	12800
-Public	2607	2477	2650	2836	3020	3201	3377	3546	3723	3909	4105
-Private	4784	3827	4210	4631	5187	5757	6333	6903	7455	8051	8696
Exports	6710	7017	7514	7803	8292	8853	9209	9609	10002	10497	11006
Imports	4529	4485	4778	5050	5354	5673	5993	6342	6703	7089	7499
Consumption	41682	40735	42837	45047	47371	49815	52385	55088	57930	60919	64062
Population	29789	30325	30871	31427	31992	32568	33155	33751	34359	34977	35607
-per capita	1399	1343	1388	1433	1481	1530	1580	1632	1686	1742	1799
exch rate	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765
CPC ($)	2068	1986	2051	2119	2189	2261	2336	2413	2492	2575	2659
YPC($)	2543	2416	2511	2599	2704	2812	2912	3013	3115	3224	3336
Dom.Savings	9572	8835	9596	10219	11145	12139	12925	13715	14477	15368	16307
FIP(ps84)	-3859	-3698	-3429	-3257	-2950	-2915	-2670	-2389	-2234	-2038	-1824
GNP	47395	45872	49004	52009	55566	59039	62641	66414	70173	74249	78545
GNP per Cap	1591	1513	1587	1655	1737	1813	1889	1968	2042	2123	2206
GNS	5713	5137	6167	6962	8195	9224	10256	11326	12243	13330	14483
ExportsGNFS	9856	9621	10428	11718	13531	15721	17842	19444	21157	23202	25427
Goods	8100	7804	8405	9467	11015	12903	14688	16017	17433	19155	21028
NFS	1756	1817	2022	2250	2516	2818	3153	3427	3724	4048	4399
ImportsGNFS	6639	6385	7188	8093	9185	10445	11836	13071	14418	15917	17574
Goods	4600	4306	4849	5503	6306	7240	8267	9174	10163	11270	12500
NFS	2039	2079	2339	2590	2879	3206	3568	3897	4255	4647	5074
Res.Balance	3217	3235	3240	3624	4346	5276	6006	6373	6739	7285	7853
Imports											
Food/Cons	239	200	219	262	315	381	459	500	546	595	650
Petroleum	507	475	453	468	486	505	522	571	624	683	747
Int'medite	3254	3131	3584	4073	4662	5347	6094	6743	7452	8247	9125
Capital	600	500	592	701	843	1008	1193	1361	1541	1745	1978
NFS	2039	2079	2339	2590	2879	3206	3568	3897	4255	4647	5074
G&NFS	6639	6385	7188	8093	9185	10445	11836	13071	14418	15917	17574
Constant											
Food/Cons	226.4	221.77	231.5	241.65	253.49	265.92	278.95	292.62	306.97	322.01	337.8
Petroleum	484	468.1	495.13	521.88	552.57	585.04	616.74	649.72	683.76	720.39	758.94
Int'medite	3193.8	3088.9	3302.9	3508.1	3735.1	3976.5	4213.5	4461.3	4718.4	4996.5	5290.6
Capital	796.7	667.79	738.48	816.83	913.98	1014.4	1116.6	1218.6	1320.7	1431.6	1552.2
NFS	2080	2128.1	2236.2	2314.7	2392.9	2473.6	2559.7	2674.9	2795.2	2921	3052.5
G&NFS	6780.9	6574.6	7004.2	7403.2	7848.1	8315.5	8785.5	9297.1	9825	10392	10992
Prices											
Food/Cons	1.06	0.90	0.95	1.08	1.24	1.43	1.64	1.71	1.78	1.85	1.92
Petroleum	1.05	1.02	0.91	0.90	0.88	0.86	0.85	0.88	0.91	0.95	0.98
Int'medite	1.02	1.01	1.09	1.16	1.25	1.34	1.45	1.51	1.58	1.65	1.72
Capital	0.75	0.75	0.80	0.86	0.92	0.99	1.07	1.12	1.17	1.22	1.27
NFS	0.98	0.98	1.05	1.12	1.20	1.30	1.39	1.46	1.52	1.59	1.66
G&NFS	0.98	0.97	1.03	1.09	1.17	1.26	1.35	1.41	1.47	1.53	1.60
MUV	98.2	97.7	104.6	111.9	120.3	129.6	139.4	145.67	152.23	159.08	166.24
FOOD	88	75	79	90.3	103.7	119.3	137.1	142.5	148.2	154.1	160.3

Exports-Value											
Beef	232	225	217	249	288	332	384	414	447	483	521
Wheat	1178	1241	1200	1183	1343	1513	1625	1648	1642	1784	1938
Corn	760	756	1069	1187	1340	1551	1736	1846	1958	2077	2202
Petroleum	446	460	409	465	697	995	1113	1345	1559	1799	2041
Oils	945	945	967	1062	1172	1297	1432	1549	1675	1812	1960
OilSeeds	624	473	468	617	696	794	876	923	972	1023	1077
Sorghum	490	541	549	616	691	773	836	858	895	943	995
Manufactures	1622	1614	1788	1993	2248	2556	2924	3266	3669	4122	4631
Other Goods	1804	1549	1739	2095	2540	3091	3763	4167	4616	5112	5662
Total:goods	8100	7804	8405	9467	11015	12903	14688	16017	17433	19155	21028
Volumes											
Beef	217	217	219	224	228	233	237	243	249	255	262
Wheat	1184	1254	1285	1175	1231	1277	1264	1233	1182	1235	1291
Corn	725	833	1234	1264	1309	1387	1424	1449	1471	1493	1515
Petroleum	447	478	441	478	680	919	974	1085	1158	1231	1287
Oils	793	911	947	985	1025	1066	1108	1153	1199	1247	1297
OilSeeds	642	598	552	671	695	726	735	743	751	759	768
Sorghum	512	588	646	664	680	693	684	672	672	680	687
Manufactures	1540	1540	1594	1661	1742	1840	1956	2091	2247	2416	2597
Other Goods	1772	1780	1896	2009	2134	2271	2418	2575	2743	2921	3111
Total:goods	7832	8199	8815	9132	9725	10411	10800	11245	11673	12237	12814
NFS	1600	1664	1747	1836	1932	2034	2144	2262	2386	2518	2656
G&NFS	9432	9863	10562	10968	11656	12445	12944	13507	14059	14755	15470
Prices											
Beef	1.07	1.04	0.99	1.12	1.26	1.43	1.62	1.70	1.79	1.89	1.99
Wheat	0.99	0.99	0.93	1.01	1.09	1.19	1.29	1.34	1.39	1.44	1.50
Corn	1.05	0.91	0.87	0.94	1.02	1.12	1.22	1.27	1.33	1.39	1.45
Petroleum	1.00	0.96	0.93	0.97	1.03	1.08	1.14	1.24	1.35	1.46	1.59
Oils	1.19	1.04	1.02	1.08	1.14	1.22	1.29	1.34	1.40	1.45	1.51
OilSeeds	0.97	0.79	0.85	0.92	1.00	1.09	1.19	1.24	1.29	1.35	1.40
Sorghum	0.96	0.92	0.85	0.93	1.02	1.12	1.22	1.28	1.33	1.39	1.45
Manufactures	1.05	1.05	1.12	1.20	1.29	1.39	1.50	1.56	1.63	1.71	1.78
Other Goods	1.02	0.87	0.92	1.04	1.19	1.36	1.56	1.62	1.68	1.75	1.82
Total:goods	1.03	0.95	0.95	1.04	1.13	1.24	1.36	1.42	1.49	1.57	1.64
RealPrices											
Beef	231	225	201	211	222	234	246	248	250	252	254
Wheat	168	168	148	149	150	152	153	152	151	151	150
Corn	138	120	107	108	110	111	113	113	113	113	113
Petroleum	29	28.1	25.3	24.8	24.3	23.9	23.4	24.3	25.2	26.2	27.2
Oils	737	645	593	585	578	570	563	560	558	555	553
OilSeeds	287	235	235	238	241	245	248	247	246	246	245
Sorghum	121	117	101	103	105	107	109	109	109	108	108
Manufactures	98	98	105	112	120	130	139	146	152	159	166
Other Goods	98	98	105	112	120	130	139	146	152	159	166
Total:goods											

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Ratios											
growth(GDP)		-3.29%	5.77%	5.40%	5.88%	5.88%	5.42%	5.35%	5.24%	5.36%	5.35%
I/Y	14.42%	12.72%	13.08%	13.51%	14.02%	14.46%	14.87%	15.19%	15.44%	15.68%	15.93%
Public	5.09%	5.00%	5.05%	5.13%	5.16%	5.17%	5.17%	5.15%	5.14%	5.12%	5.11%
Private	9.33%	7.72%	8.03%	8.38%	8.86%	9.29%	9.70%	10.03%	10.30%	10.55%	10.82%
ICOR		-4.39	2.20	2.42	2.30	2.39	2.67	2.78	2.90	2.88	2.93
Exp/y	13.09%	14.15%	14.33%	14.12%	14.17%	14.29%	14.10%	13.97%	13.81%	13.76%	13.69%
IMp/y	8.84%	9.05%	9.11%	9.14%	9.15%	9.16%	9.18%	9.22%	9.26%	9.29%	9.33%
TTI	1.06	0.98	0.93	0.95	0.97	0.99	1.01	1.01	1.02	1.02	1.03
Sd/y	18.68%	17.82%	18.30%	18.49%	19.05%	19.59%	19.79%	19.93%	19.99%	20.15%	20.29%
growth Cons		-2.27%	5.16%	5.16%	5.16%	5.16%	5.16%	5.16%	5.16%	5.16%	5.16%
-Inv.pub		-5.00%	7.00%	7.00%	6.50%	6.00%	5.50%	5.00%	5.00%	5.00%	5.00%
-inv.pri		-20.00%	10.00%	10.00%	12.00%	11.00%	10.00%	9.00%	8.00%	8.00%	8.00%
-cons/pop		-4.00%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%	3.30%
-imports		-0.97%	6.53%	5.70%	6.01%	5.96%	5.65%	5.82%	5.68%	5.77%	5.78%
-exports		4.57%	7.09%	3.84%	6.27%	6.76%	4.01%	4.34%	4.09%	4.95%	4.85%
-GNP		-3.21%	6.83%	6.13%	6.84%	6.25%	6.10%	6.02%	5.66%	5.81%	5.79%
PublicSav	6150	3420	3985	4034	4038	4213	4245	4197	4200	4272	4260
PNubSav/GDP	12.00%	6.90%	7.60%	7.30%	6.90%	6.80%	6.50%	6.10%	5.80%	5.60%	5.30%
PrivateSav	3421.5	5414.9	5610.8	6184.4	7107.3	7925.9	8680.1	9518	10278	11096	12048
PrvSav/GDP	6.68%	10.92%	10.70%	11.19%	12.15%	12.79%	13.29%	13.83%	14.19%	14.55%	14.99%

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
ExportsGNFS	9856	9621	10428	11718	13531	15721	17842	19444	21157	23202	25427
Goods	8100	7804	8405	9467	11015	12903	14688	16017	17433	19155	21028
NFS	1756	1817	2022	2250	2516	2818	3153	3427	3724	4048	4399
ImportsGNFS	6639	6385	7188	8093	9185	10445	11836	13071	14418	15917	17574
Goods	4600	4306	4849	5503	6306	7240	8267	9174	10163	11270	12500
NFS	2039	2079	2339	2590	2879	3206	3568	3897	4255	4647	5074
Res.Balance	3217	3235	3240	3624	4346	5276	6006	6373	6739	7285	7853
FactorServices	-5705	-5439	-5394	-5481	-5364	-5753	-5845	-5607	-5641	-5727	-5819
Receipts	297	336	360	375	389	412	432	446	465	486	509
Interest	264	303	325	337	349	368	386	397	414	433	453
Other	33	33	35	38	40	44	47	49	51	53	56
Payments	6002	5776	5754	5856	5753	6164	6278	6054	6106	6213	6328
Interest	5542	5289	5244	5320	5187	5563	5636	5366	5366	5415	5465
DirectInv.	438	465	486	511	539	572	611	656	706	762	825
Other	22	22	23	25	27	29	31	33	34	36	37
Transfers	1	15	16	17	18	20	21	22	23	24	25
CurrentAcct.	-2487	-2189	-2138	-1840	-999	-457	182	788	1122	1583	2059
DirectInvst.	269	214	246	285	330	384	447	502	564	633	711
NetM&LT-OFF	91	742	1276	840	1260	1041	784	304	23	-59	-140
Disbursements	437	1077	1774	1204	1691	1675	1513	1149	965	950	950
IBRD	96	146	478	672	970	968	923	637	500	500	500
IDB	195	236	470	157	227	262	269	265	249	250	250
OthOfficial	146	695	826	375	494	445	321	247	216	200	200
Amortization	346	335	498	364	431	634	729	845	942	1009	1090
IBRD	80	116	149	161	159	178	198	268	317	419	484
IDB	82	76	100	35	50	68	118	134	172	171	176
OthOfficial	184	143	249	168	222	388	413	443	453	419	430
Outstd.DEBT	6476	7286	8562	9402	10662	11703	12487	12791	12814	12755	12615
IBRD	549	656	985	1496	2307	3097	3822	4191	4374	4455	4471
IDB	944	1095	1465	1587	1764	1958	2109	2240	2317	2396	2470
OthOfficial	4983	5535	6112	6319	6591	6648	6556	6360	6123	5904	5674
NetM&LT-PRV	-386	2658	1028	1690	374	-782	-1315	-733	0	0	0
Disbursements	83	3423	2010	1690	374						
Amortization	469	765	982			782	1315	733	0	0	0
Outstd.DEBT	33633	36291	37057	38747	39121	38339	37024	36291	36291	36291	36291
NetShortTrm	-307	-1565	-505	-500	-500	465	554	440	473	557	611
Outstd.DEBT	6570	5005	4500	4000	3500	3965	4519	4959	5432	5989	6600
TargetST	2500	2384	2609	2947	3410	3965	4519	4959	5432	5989	6600
Cap n.e.i.	2891	0	0	0	0	0	0	-681	-1570	-2445	-2945
Net IMF	0	702	400	-300	-300	-372	-400	-450	-378		
Reserve Chg.	-71	-562	-306	-174	-165	-279	-251	-169	-234	-268	-296
Res.Level	2637	3199	3505	3680	3845	4124	4375	4544	4778	5046	5342
Res/Imp	2.50	3.16	3.25	3.17	3.09	2.98	2.90	2.85	2.79	2.74	2.68
TotalDebt	46679	48582	50119	52149	53283	54007	54030	54041	54537	55035	55506
Debt/Exports	4.74	5.05	4.81	4.45	3.94	3.44	3.03	2.78	2.58	2.37	2.18
DSR	131%	118%	108%	83%	67%	70%	68%	61%	55%	54%	52%
DSR.xST	64%	66%	64%	49%	42%	44%	43%	36%	30%	28%	26%

MUV	100	99.5	106.47	113.92	122.46	131.89	141.91	148.3	154.97	161.95	169.24
Priv.Inv	4784	3827.2	4114.2	4443.4	4798.8	5182.8	5597.4	6017.2	6468.5	6953.6	7475.1
Int.rate%-FI		10.8	10.9	10.7	10	10.5	10.5	10	10	10	10
-WBK/IDB		9.8	10.2	10.2	9.7	10.2	10.2	9.7	9.7	9.7	9.7
Interest-OFF		635	743	873	912	1088	1194	1211	1241	1243	1237
-PRV		3632	3956	3965	3875	4108	4026	3702	3629	3629	3629
-SHTRM		1022	546	482	400	368	416	452	496	543	599
TOTAL		5289	5244	5320	5187	5563	5636	5366	5366	5415	5465
IntCov.Ratio	61%	65%	66%	73%	90%	102%	114%	128%	136%	146%	157%
Debt/GDP	62%	67%	62%	58%	53%	48%	42%	39%	36%	33%	31%
IMFNetPos.	1098	1800	2200	1900	1600	1228	828	378	0	0	0
TotDebtincIMF	47777	50382	52319	54049	54883	55235	54858	54419	54537	55035	55506
TotDebt/GDP	63%	69%	65%	60%	55%	49%	43%	39%	36%	33%	31%
GDP(ps84)	51254	49570	51305	53151	55555	58080	60674	63344	66062	68988	72043
GDP($84)	75763	73275	75840	78567	82121	85853	89688	93635	97653	101978	106493
GDP($cur)	75763	72908	80743	89502	100567	113232	127281	138862	151337	165151	180225
GDS(ps84)	9572	8835.3	9629.9	10301	11279	12331	13171	14018	14844	15805	16820
GDS($cur)	14149	12995	15155	17345	20418	24040	27629	30731	34006	37837	42077
Interest/GDS	37%	38%	32%	29%	24%	22%	19%	16%	15%	13%	12%
Interest/GDP	7%	7%	6%	6%	5%	5%	4%	4%	3%	3%	3%
Chg.Exposure		4%	4%	4%	2%	1%	0%	-1%	-2%	-4%	-4%
FIP(real)	-5705	-5467	-5067	-4812	-4380	-4362	-4119	-3781	-3640	-3536	-3438
FIP(ps84)	-3859	-3698	-3428	-3255	-2963	-2951	-2786	-2558	-2462	-2392	-2326

	1985	1986	1987	1988	1989	1990	TOTAL
Commitments							
WORLD BANK	240	630	800	900	900	900	4370
IDB	400	400	300	200	200	200	1700
OFFICIAL-OTHER	1100	1200	900	800	800	700	5500
PRIVATE	3423	1859	1690	0	0	0	6972
TOTAL	5163	4089	3690	1900	1900	1800	18542
Disbursements							
WORLD BANK	146	478	672	970	968	923	4157
IDB	236	470	157	227	262	269	1621
OFFICIAL-OTHER	695	826	375	494	445	321	3156
PRIVATE	3423	2010	1690	374	0	0	7497
TOTAL	4500	3784	2894	2065	1675	1513	16431
NetFlows							
WORLD BANK	30	329	511	811	790	725	3196
IDB	160	370	122	177	194	151	1174
OFFICIAL-OTHER	552	577	207	272	57	-92	1573
PRIVATE	2658	1028	1690	374	-782	-1315	3653
TOTAL	3400	2304	2530	1634	259	-531	9596
Amortization							
WORLD BANK	116	149	161	159	178	198	961
IDB	76	100	35	50	68	118	447
OTHEROFFICIAL	143	249	168	222	388	413	1583
PRIVATE	765	982	0	0	782	1315	3844
TOTAL	1100	1480	364	431	1416	2044	6835

DOD							Change 84-90	% SHARE
WORLD BANK	579	985	1496	2307	3097	3822	3196	33%
IDB	1104	1465	1587	1764	1958	2109	1174	12%
OFFICIAL-OTHER	5535	6112	6319	6591	6648	6556	1573	16%
PRIVATE	36291	37319	38747	39121	38339	37024	3653	38%
TOTAL	50765	51296	52730	53942	54681	55014	9596	100%

	1985	1986	1987	1988	1989	1990	Total85-90
HIGHCASE							
CurrentDeficit	-2189	-2138	-1840	-999	-457	182	-7442
DirectForeignIn	214	246	285	330	384	447	1906
NetOfficialSou	742	1276	840	1260	1041	784	5943
-WORLD BANK	30	329	511	811	790	725	3196
-IDB	160	370	122	177	194	151	1174
-OTHER	552	577	207	272	57	-92	1573
NetPrivateSour	1093	523	1190	-126	-317	-761	1601
Net IMF	702	400	-300	-300	-372	-400	-270
Reserve Chg.	-562	-306	-174	-165	-279	-251	-1738

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP	51254	49776	51560	53171	54899	56673	58393	60169	61993	63955	65992
Investment	7391	6538	6934	7376	7849	8355	8896	9448	10036	10664	11334
-Public	2607	2711	2820	2933	3050	3172	3299	3431	3568	3711	3859
-Private	4784	3827.2	4114	4443	4799	5183	5597	6017	6468	6954	7475
Exports	6710	7017	7557	7827	8163	8492	8706	8959	9204	9529	9867
Imports	4529	4514	4710	4882	5062	5248	5439	5654	5878	6117	6366
Consumption	41682	40735	41779	42850	43949	45075	46231	47416	48631	49878	51157
Population	29789	30325	30871	31427	31992	32568	33155	33751	34359	34977	35607
-per capita	1399	1343	1353	1363	1374	1384	1394	1405	1415	1426	1437
exch rate	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765
CPC ($)	2068	1986	2001	2016	2031	2046	2061	2077	2092	2108	2124
Dom.Savings	9572	9041	9781	10321	10950	11598	12162	12753	13362	14077	14835
FIP	-3864										
Nat.Savings	5708										
InvrtFactor		1.049	1.049	1.049	1.049	1.049	1.049	1.049	1.049	1.049	1.049
ExportsGNFS	9856	9874	10801	11988	13466	15124	16734	18016	19362	20961	22697
Goods	8100	8057	8779	9737	10950	12306	13580	14589	15638	16913	18298
NFS	1756	1817	2022	2250	2516	2818	3153	3427	3724	4048	4399
ImportsGNFS	6639	6421	7081	7819	8683	9668	10748	11660	12652	13739	14924
Goods	4600	4342	4742	5229	5805	6462	7180	7764	8397	9092	9850
NFS	2039	2079	2339	2590	2879	3206	3568	3897	4255	4647	5074
Res.Balance	3217	3453	3720	4168	4782	5456	5986	6356	6710	7222	7772
FIP	-5712										
Transfers	3										
CurrentAcct	-2492										
Imports											
Food/Cons	239	200	215	251	295	348	409	435	463	492	524
Petroleum	507	477	445	450	456	462	466	499	534	573	614
Int'medite	3254	3144	3487	3847	4270	4749	5263	5667	6101	6577	7092
Capital	600	521	595	681	784	904	1042	1163	1298	1450	1620
NFS	2039	2079	2339	2590	2879	3206	3568	3897	4255	4647	5074
G&NFS	6639	6421	7081	7819	8683	9668	10748	11660	12652	13739	14924
Constant											
Food/Cons	226.4	221.77	226.89	232.12	237.48	242.96	248.56	254.3	260.16	266.17	272.31
Petroleum	484	470.04	486.89	502.1	518.42	535.17	551.42	568.19	585.41	603.93	623.17
Int'medite	3193.8	3101.7	3212.9	3313.3	3420.9	3531.5	3638.7	3749.3	3863	3985.2	4112.2
Capital	796.7	695.61	741.9	793.91	849.89	910.14	975.03	1041.6	1112.9	1189.5	1271.7
NFS	2080	2128.1	2236.2	2314.7	2392.9	2473.6	2559.7	2674.9	2795.2	2921	3052.5
G&NFS	6780.9	6617.2	6904.8	7156.1	7419.6	7693.4	7973.4	8288.2	8616.7	8965.9	9331.8
Prices											
Food/Cons	1.06	0.90	0.95	1.08	1.24	1.43	1.64	1.71	1.78	1.85	1.92
Petroleum	1.05	1.02	0.91	0.90	0.88	0.86	0.85	0.88	0.91	0.95	0.98
Int'medite	1.02	1.01	1.09	1.16	1.25	1.34	1.45	1.51	1.58	1.65	1.72
Capital	0.75	0.75	0.80	0.86	0.92	0.99	1.07	1.12	1.17	1.22	1.27
NFS	0.98	0.98	1.05	1.12	1.20	1.30	1.39	1.46	1.52	1.59	1.66
G&NFS	0.98	0.97	1.03	1.09	1.17	1.26	1.35	1.41	1.47	1.53	1.60
MUV	98.2	97.7	104.6	111.9	120.3	129.6	139.4	145.67	152.23	159.08	166.24
FOOD	88	75	79	90.3	103.7	119.3	137.1	142.5	148.2	154.1	160.3

Exports-Value											
Beef	232	225	217	249	288	332	384	414	447	483	521
Wheat	1178	1241	1200	1183	1343	1495	1519	1540	1535	1667	1811
Corn	760	756	1069	1187	1336	1546	1693	1788	1890	1997	2110
Petroleum	446	460	465	503	546	594	645	722	807	902	1008
Oils	945	945	967	1062	1172	1297	1432	1549	1675	1812	1960
OilSeeds	624	473	468	617	695	773	854	899	947	997	1049
Sorghum	490	541	549	616	691	737	806	838	884	932	983
Manufactures	1622	1614	1788	1989	2235	2527	2855	3133	3438	3772	4139
Other Goods	1804	1803	2055	2331	2643	3004	3393	3705	4015	4351	4715
Total:goods	8100	8057	8779	9737	10950	12306	13580	14589	15638	16913	18298
Volumes											
Beef	217	217	219	224	228	233	237	243	249	255	262
Wheat	1184	1254	1285	1175	1231	1261	1181	1152	1105	1154	1206
Corn	725	833	1234	1264	1305	1382	1389	1404	1420	1436	1452
Petroleum	447	478	502	517	532	548	565	582	599	617	636
Oils	793	911	947	985	1025	1066	1108	1153	1199	1247	1297
OilSeeds	642	598	552	671	694	707	716	724	732	740	748
Sorghum	512	588	646	664	680	661	659	657	664	672	679
Manufactures	1540	1540	1594	1658	1732	1819	1910	2005	2106	2211	2321
Other Goods	1772	1780	1896	2009	2120	2237	2348	2454	2545	2639	2737
Total:goods	7832	8199	8876	9168	9549	9914	10114	10375	10618	10971	11337
NFS	1600	1664	1747	1835	1926	2023	2124	2219	2319	2424	2533
G&NFS	9432	9863	10623	11002	11475	11937	12237	12594	12938	13394	13870
Prices											
Beef	1.07	1.04	0.99	1.12	1.26	1.43	1.62	1.70	1.79	1.89	1.99
Wheat	0.99	0.99	0.93	1.01	1.09	1.19	1.29	1.34	1.39	1.44	1.50
Corn	1.05	0.91	0.87	0.94	1.02	1.12	1.22	1.27	1.33	1.39	1.45
Petroleum	1.00	0.96	0.93	0.97	1.03	1.08	1.14	1.24	1.35	1.46	1.59
Oils	1.19	1.04	1.02	1.08	1.14	1.22	1.29	1.34	1.40	1.45	1.51
OilSeeds	0.97	0.79	0.85	0.92	1.00	1.09	1.19	1.24	1.29	1.35	1.40
Sorghum	0.96	0.92	0.85	0.93	1.02	1.12	1.22	1.28	1.33	1.39	1.45
Manufactures	1.05	1.05	1.12	1.20	1.29	1.39	1.50	1.56	1.63	1.71	1.78
Other Goods	1.02	1.01	1.08	1.16	1.25	1.34	1.44	1.51	1.58	1.65	1.72
Total:goods	1.03	0.98	0.99	1.06	1.15	1.24	1.34	1.41	1.47	1.54	1.61
RealPrices											
Beef	231	225	201	211	222	234	246	248	250	252	254
Wheat	168	168	148	149	150	152	153	152	151	151	150
Corn	138	120	107	108	110	111	113	113	113	113	113
Petroleum	29	28.1	25.3	24.8	24.3	23.9	23.4	24.3	25.2	26.2	27.2
Oils	737	645	593	585	578	570	563	560	558	555	553
OilSeeds	287	235	235	238	241	245	248	247	246	246	245
Sorghum	121	117	101	103	105	107	109	109	109	108	108
Manufactures	98	98	105	112	120	130	139	146	152	159	166
Other Goods	98	98	105	112	120	130	139	146	152	159	166
Total:goods											

Ratios											
growth(GDP)		-2.88%	3.58%	3.12%	3.25%	3.23%	3.03%	3.04%	3.03%	3.16%	3.19%
I/Y	14.42%	13.14%	13.45%	13.87%	14.30%	14.74%	15.23%	15.70%	16.19%	16.67%	17.18%
Public	5.09%	5.45%	5.47%	5.52%	5.56%	5.60%	5.65%	5.70%	5.76%	5.80%	5.85%
Private	9.33%	7.69%	7.98%	8.36%	8.74%	9.14%	9.59%	10.00%	10.43%	10.87%	11.33%
ICOR		-5.00	3.66	4.30	4.27	4.42	4.86	5.01	5.18	5.12	5.23
Exp/y	13.09%	14.10%	14.66%	14.72%	14.87%	14.98%	14.91%	14.89%	14.85%	14.90%	14.95%
IMp/y	8.84%	9.07%	9.14%	9.18%	9.22%	9.26%	9.32%	9.40%	9.48%	9.56%	9.65%
TTI	1.06	1.01	0.96	0.97	0.98	0.99	1.00	1.00	1.00	1.01	1.01
Sd/y	18.68%	18.16%	18.97%	19.41%	19.95%	20.46%	20.83%	21.20%	21.55%	22.01%	22.48%
growth Cons		-2.27%	2.56%	2.56%	2.56%	2.56%	2.56%	2.56%	2.56%	2.56%	2.56%
-Inv.pub		4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
-inv.pri		-20.00%	7.50%	8.00%	8.00%	8.00%	8.00%	7.50%	7.50%	7.50%	7.50%
-cons/pop		-4.00%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%
-imports		-0.33%	4.35%	3.64%	3.68%	3.69%	3.64%	3.95%	3.96%	4.05%	4.08%
-exports		4.57%	7.71%	3.57%	4.30%	4.02%	2.52%	2.91%	2.73%	3.53%	3.55%

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
GDP	51254	49776	51856	53864	56233	58747	61296	63895	66567	69444	72459
Investment	7391	6538	6934	7376	7938	8548	9213	9877	10530	11230	11980
-Public	2607	2711	2820	2933	3050	3172	3299	3431	3568	3711	3859
-Private	4784	3827.2	4114	4443	4888	5376	5914	6446	6962	7519	8121
Exports	6710	7017	7557	7831	8187	8590	8918	9251	9604	10060	10542
Imports	4529	4514	4726	4919	5140	5375	5621	5890	6167	6464	6777
Consumption	41682	40735	42090	43576	45248	46984	48786	50657	52600	54618	56713
Population	29789	30325	30871	31427	31992	32568	33155	33751	34359	34977	35607
-per capita	1399	1343	1363	1387	1414	1443	1471	1501	1531	1562	1593
exch rate	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765	0.6765
CPC ($)	2068	1986	2015	2050	2091	2132	2175	2219	2263	2308	2354
Dom.Savings	9572	9041	9765	10288	10985	11763	12510	13237	13967	14826	15745
FIP	-3864										
Nat.Savings	5708										
InvrtFactor		1.049	1.049	1.049	1.049	1.049	1.049	1.049	1.049	1.049	1.049
ExportsGNFS	9856	9874	10801	11991	13501	15279	17105	18541	20117	22010	24092
Goods	8100	8057	8779	9741	10985	12461	13952	15114	16393	17962	19693
NFS	1756	1817	2022	2250	2516	2818	3153	3427	3724	4048	4399
ImportsGNFS	6639	6421	7105	7880	8818	9898	11101	12139	13264	14508	15872
Goods	4600	4342	4766	5290	5939	6693	7533	8243	9009	9861	10798
NFS	2039	2079	2339	2590	2879	3206	3568	3897	4255	4647	5074
Res.Balance	3217	3453	3696	4112	4683	5380	6004	6402	6852	7502	8219
FIP	-5712										
Transfers	3										
CurrentAcct	-2492										
Imports											
Food/Cons	239	200	216	255	303	361	429	461	497	534	575
Petroleum	507	477	448	456	467	479	490	530	574	622	674
Int'medite	3254	3144	3507	3897	4374	4922	5524	6018	6551	7142	7787
Capital	600	521	595	681	795	931	1090	1233	1388	1563	1762
NFS	2039	2079	2339	2590	2879	3206	3568	3897	4255	4647	5074
G&NFS	6639	6421	7105	7880	8818	9898	11101	12139	13264	14508	15872
Constant											
Food/Cons	226.4	221.77	228.41	235.67	243.81	252.22	260.93	269.94	279.26	288.9	298.87
Petroleum	484	470.04	489.68	508.65	531.02	554.76	578.83	603.37	628.61	655.77	684.24
Int'medite	3193.8	3101.7	3231.3	3356.4	3504.1	3660.7	3819.5	3981.5	4148	4327.3	4515.1
Capital	796.7	695.61	741.9	794.38	862.13	937.09	1020.1	1104.7	1189.4	1281.9	1382.9
NFS	2080	2128.1	2236.2	2314.7	2392.9	2473.6	2559.7	2674.9	2795.2	2921	3052.5
G&NFS	6780.9	6617.2	6927.5	7209.9	7533.9	7878.4	8239.1	8634.4	9040.6	9474.9	9933.6
Prices											
Food/Cons	1.06	0.90	0.95	1.08	1.24	1.43	1.64	1.71	1.78	1.85	1.92
Petroleum	1.05	1.02	0.91	0.90	0.88	0.86	0.85	0.88	0.91	0.95	0.98
Int'medite	1.02	1.01	1.09	1.16	1.25	1.34	1.45	1.51	1.58	1.65	1.72
Capital	0.75	0.75	0.80	0.86	0.92	0.99	1.07	1.12	1.17	1.22	1.27
NFS	0.98	0.98	1.05	1.12	1.20	1.30	1.39	1.46	1.52	1.59	1.66
G&NFS	0.98	0.97	1.03	1.09	1.17	1.26	1.35	1.41	1.47	1.53	1.60
MUV	98.2	97.7	104.6	111.9	120.3	129.6	139.4	145.67	152.23	159.08	166.24
FOOD	88	75	79	90.3	103.7	119.3	137.1	142.5	148.2	154.1	160.3

Exports-Value											
Beef	232	225	217	249	288	332	384	414	447	483	521
Wheat	1178	1241	1200	1183	1343	1513	1625	1648	1642	1784	1938
Corn	760	756	1069	1187	1340	1551	1736	1846	1958	2077	2202
Petroleum	446	460	465	503	546	594	645	722	807	902	1008
Oils	945	945	967	1062	1172	1297	1432	1549	1675	1812	1960
OilSeeds	624	473	468	617	696	794	876	923	972	1023	1077
Sorghum	490	541	549	616	691	773	836	858	895	943	995
Manufactures	1622	1614	1788	1993	2248	2556	2924	3266	3669	4122	4631
Other Goods	1804	1803	2055	2331	2661	3050	3494	3889	4328	4816	5360
Total:goods	8100	8057	8779	9741	10985	12461	13952	15114	16393	17962	19693
Volumes											
Beef	217	217	219	224	228	233	237	243	249	255	262
Wheat	1184	1254	1285	1175	1231	1277	1264	1233	1182	1235	1291
Corn	725	833	1234	1264	1309	1387	1424	1449	1471	1493	1515
Petroleum	447	478	502	517	532	548	565	582	599	617	636
Oils	793	911	947	985	1025	1066	1108	1153	1199	1247	1297
OilSeeds	642	598	552	671	695	726	735	743	751	759	768
Sorghum	512	588	646	664	680	693	684	672	672	680	687
Manufactures	1540	1540	1594	1661	1742	1840	1956	2091	2247	2416	2597
Other Goods	1772	1780	1896	2009	2134	2271	2418	2575	2743	2921	3111
Total:goods	7832	8199	8876	9171	9577	10040	10391	10741	11114	11624	12163
NFS	1600	1664	1747	1836	1932	2034	2144	2262	2386	2518	2656
G&NFS	9432	9863	10623	11007	11509	12074	12535	13003	13500	14141	14819
Prices											
Beef	1.07	1.04	0.99	1.12	1.26	1.43	1.62	1.70	1.79	1.89	1.99
Wheat	0.99	0.99	0.93	1.01	1.09	1.19	1.29	1.34	1.39	1.44	1.50
Corn	1.05	0.91	0.87	0.94	1.02	1.12	1.22	1.27	1.33	1.39	1.45
Petroleum	1.00	0.96	0.93	0.97	1.03	1.08	1.14	1.24	1.35	1.46	1.59
Oils	1.19	1.04	1.02	1.08	1.14	1.22	1.29	1.34	1.40	1.45	1.51
OilSeeds	0.97	0.79	0.85	0.92	1.00	1.09	1.19	1.24	1.29	1.35	1.40
Sorghum	0.96	0.92	0.85	0.93	1.02	1.12	1.22	1.28	1.33	1.39	1.45
Manufactures	1.05	1.05	1.12	1.20	1.29	1.39	1.50	1.56	1.63	1.71	1.78
Other Goods	1.02	1.01	1.08	1.16	1.25	1.34	1.44	1.51	1.58	1.65	1.72
Total:goods	1.03	0.98	0.99	1.06	1.15	1.24	1.34	1.41	1.47	1.55	1.62
Real Prices											
Beef	231	225	201	211	222	234	246	248	250	252	254
Wheat	168	168	148	149	150	152	153	152	151	151	150
Corn	138	120	107	108	110	111	113	113	113	113	113
Petroleum	29	28.1	25.3	24.8	24.3	23.9	23.4	24.3	25.2	26.2	27.2
Oils	737	645	593	585	578	570	563	560	558	555	553
OilSeeds	287	235	235	238	241	245	248	247	246	246	245
Sorghum	121	117	101	103	105	107	109	109	109	108	108
Manufactures	98	98	105	112	120	130	139	146	152	159	166
Other Goods	98	98	105	112	120	130	139	146	152	159	166
Total:goods											

Ratios											
growth(GDP)		-2.88%	4.18%	3.87%	4.40%	4.47%	4.34%	4.24%	4.18%	4.32%	4.34%
I/Y	14.42%	13.14%	13.37%	13.69%	14.12%	14.55%	15.03%	15.46%	15.82%	16.17%	16.53%
Public	5.09%	5.45%	5.44%	5.44%	5.42%	5.40%	5.38%	5.37%	5.36%	5.34%	5.33%
Private	9.33%	7.69%	7.93%	8.25%	8.69%	9.15%	9.65%	10.09%	10.46%	10.83%	11.21%
ICOR		-5.00	3.14	3.45	3.11	3.16	3.35	3.54	3.70	3.66	3.73
Exp/y	13.09%	14.10%	14.57%	14.54%	14.56%	14.62%	14.55%	14.48%	14.43%	14.49%	14.55%
IMp/y	8.84%	9.07%	9.11%	9.13%	9.14%	9.15%	9.17%	9.22%	9.27%	9.31%	9.35%
TTI	1.06	1.01	0.96	0.97	0.98	0.99	1.00	1.00	1.01	1.01	1.01
Sd/y	18.68%	18.16%	18.83%	19.10%	19.54%	20.02%	20.41%	20.72%	20.98%	21.35%	21.73%
growth Cons		-2.27%	3.33%	3.53%	3.84%	3.84%	3.84%	3.84%	3.84%	3.84%	3.84%
-Inv.pub		4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
-inv.pri		-20.00%	7.50%	8.00%	10.00%	10.00%	10.00%	9.00%	8.00%	8.00%	8.00%
-cons/pop		-4.00%	1.50%	1.70%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
-imports		-0.33%	4.69%	4.08%	4.50%	4.57%	4.58%	4.80%	4.70%	4.80%	4.84%
-exports		4.57%	7.71%	3.62%	4.56%	4.91%	3.82%	3.73%	3.82%	4.75%	4.79%

ARGENTINA DEBT PROJECTIONS

($ Millions)

	1985	1986	1987	1988	1989	1990	Total 85-90
BASE CASE							
Current Deficit	1706	1531	1268	1059	801	489	6854
Direct Foreign Investmt	190	250	300	340	370	390	1840
Net Official Source	287	423	660	688	610	416	3084
-WORLD BANK	133	112	165	165	151	119	845
-IDB	4	50	122	192	241	251	860
-OTHER	150	261	373	331	218	46	1379
Net Private Source	490	8	458	181	343	33	1513
Net IMF	600	800	-300	-300	-372	-400	28
Reserve Increase	139	50	150	150	-150	50	389
HIGH CASE							
Current Deficit	1718	2173	2021	1756	1380	842	9890
Direct Foreign Investmt	190	250	300	340	370	390	1840
Net Official Source	287	423	660	688	610	416	3084
-WORLD BANK	133	112	165	165	151	119	845
-IDB	4	50	122	192	241	251	860
-OTHER	150	261	373	331	218	46	1379
Net Private Source	502	650	1211	878	922	386	4549
Net IMF	600	800	-300	-300	-372	-400	28
Reserve Increase	139	50	150	150	-150	50	389

ARGENTINA DEBT PROJECTIONS

($ Millions)

BASE CASE

Commitments

	1985	1986	1987	1988	1989	1990	TOTAL
WORLD BANK	175	535	350	325	300	150	1835
IDB	400	400	300	200	200	200	1700
OFFICIAL EXPORT	600	600	400	400	200	200	2400
OTHER (PIPELINE)							
SUPPLIERS CREDITS	500	600	500	400	600	500	3100
PRIVATE GUARANTEED	2422	3086	4179	3179	2563	2973	18402
PRIVATE NON-GUARANTEED	500	500	500	400	500	500	2900
GAPFILLER	0	129	237	337	503	674	1880
TOTAL	4597	5850	6466	5241	4866	5197	32217

Disbursements

	1985	1986	1987	1988	1989	1990	TOTAL
WORLD BANK	252	279	326	324	324	324	1829
IDB	36	86	157	227	263	270	1039
OFFICIAL EXPORT	138	362	476	464	430	312	2182
OTHER (PIPELINE)	200	74	50	31	15	11	381
SUPPLIERS CREDITS	203	330	396	460	513	513	2415
PRIVATE GUARANTEED	2422	3086	4179	3179	2563	2973	18402
PRIVATE NON-GUARANTEED	500	500	500	400	500	500	2900
GAPFILLER	0	129	237	337	503	674	1880
TOTAL	3751	4846	6321	5422	5111	5577	31028

Net Flows

	1985	1986	1987	1988	1989	1990	TOTAL
WORLD BANK	133	112	165	165	151	119	845
IDB	4	50	122	192	241	251	860
OFFICIAL EXPORT	86	317	435	407	319	153	1717
OTHER (PIPELINE)	64	-56	-62	-76	-101	-107	-338
SUPPLIERS CREDITS	-43	63	126	167	195	163	671
PRIVATE GUARANTEED	312	-584	-89	-200	-768	-979	-2308
PRIVATE NON-GUARANTEED	500	500	500	220	220	120	2060
GAPFILLER	0	129	237	337	482	613	1798
TOTAL	1056	531	1434	1212	739	333	5305

Amortization

	1985	1986	1987	1988	1989	1990	TOTAL
WORLD BANK	119	167	161	159	173	205	984
IDB	32	36	35	35	22	19	179
OFFICIAL EXPORT	52	45	41	57	111	159	465
OTHER (PIPELINE)	136	130	112	107	116	118	719
SUPPLIERS CREDITS	246	267	270	293	318	350	1744
PRIVATE GUARANTEED	2110	3670	4268	3379	3331	3952	20710
PRIVATE NON-GUARANTEED	0	0	0	180	280	380	840
GAPFILLER	0	0	0	0	21	61	82
TOTAL	2695	4315	4887	4210	4372	5244	25723

DOD (Exposure)

	1985	1986	1987	1988	1989	1990	Change 84-90	Base % Share	High % Share
WORLD BANK	765	877	1042	1207	1358	1477	845	16	9
IDB	334	384	506	698	939	1190	860	16	9
OFFICIAL	1372	1696	2195	2693	3106	3315	2050	39	21
BANKS & SUPPLIERS	48294	48339	48987	49344	49278	49032	1550	29	61
TOTAL	50765	51296	52730	53942	54681	55014	5305	100	100

9643

December 4, 1985

Mr. Stern:

Below, I have some brief observations for your consideration on the Argentina and Morocco adjustment programs.

(i) It would be useful to have a very brief "initial conditions" of these economies at the start. A table like that of Annex III (Argentina) and a brief description is what I have in mind.

(ii) The objectives of the economic adjustment programs over the next five years should follow. These objectives should be in terms of a few key parameters such as growth rates (given in both studies), debt/GDP; debt-service ratios; interest payments/GDP. This should be followed by the implications for public savings, private savings, public investment, private investment and exports. The economic adjustment program and policies could then be discussed in relation to each of these areas.

(iii) The policy matrix presented in the Argentina case (Annex II?) is a good idea. You might wish to encourage that approach in the other studies. I believe most of the LAC studies will be doing this. The "Policy Areas" could be standardized (to the extent possible); most countries will probably have to focus on the same set of policy areas, but with differing emphasis.

(iv) Within such a policy framework, priorities should be specified much more than has been done in the case of Morocco. This should fall out if annual action programs are carefully specified.

(v) Neither program identifies the links between the policies. Will undertaking Policy A make it easier to undertake Policy B? Morocco does touch on this issue. In general, this will be difficult to do, but it could provide a basis for identifying priorities, the sequencing of reforms and annual action programs.

(vi) The approach to the monitoring of reforms, the role of the IMF and collaboration with the Bank in implementing and monitoring the economic adjustment program, has not been spelled out in Argentina. There is, however, some mention in the case of Morocco.

(vii) The resource requirements, by amounts and source over the next five years could be more explicitly discussed and usefully presented in a tabular form in both cases.

(viii) The Morocco study focuses too much in the text on the past; this could be better done in the policy matrix as in Argentina. The textual presentation "breaks up" an integrated adjustment program.

(ix) It may also be useful to have a distinction drawn between what is "necessary" to achieve the objectives specified in terms of the key parameters, and what, in the judgment of the region, is "likely" and why. This would be useful in formulating some judgment about whether the countries will succeed in resuming sustained growth and restoring their creditworthiness, and the implications for the Bank's own lending program if what is necessary is not undertaken.

(x) Finally, neither program, in my judgment, places adequate emphasis on the importance of stabilization (and maintaining the stabilization program in Argentina) as a precondition for the success of the adjustment programs. This is also where the role of the Fund could be woven in.

Hope you find some of these observations useful.

Armeane

cc: Mr. Husain

* GNP.

GNP/cap.

Total Debt.

D/GNP.

* D/X.

Int Pay/X.

DS/X.

Public Sav.

Priv. Sav.

Public Inv.

Private Inv.

* Exports

Imports.

~~Cons/Cap.~~

½ 7yr. constrait. Cons/Cap.

Mr Chakri

ARGENTINA--Medium-Term Economic Recovery Proposal

1. Initial Conditions (Background)
   Economic Performance
   - inappropriate economic management
   - external problems

   Stabilization policies
   - Plan Austral
   - overall fiscal deficit
   - monetary reform
   - wage and price freeze

2. Objectives of the medium-term program
   - Debt/exports
   - Increase in per capita consumption
   - GDP growth

3. Implications of the objectives of the medium-term program
   - public/private investments
   - public/private savings
   - exports
   - imports
   - debt rescheduling
   - capitalization of interest
   - fiscal and monetary
   - exchange rate

4. Policies and institutions necessary
   - agriculture
   - trade and industry
   - financial sector
   - energy sector
   - public sector
   - transportation

5. Policy Priorities
   - agriculture
   - energy
   - industry and trade
   - financial sector
   - public sector
   - transportation

6. Annual Action Programs
   1986 Policy emphasis, sectors, measures
   1987 Policy emphasis, sectors, measures
   1988 Policy emphasis, sectors, measures
   1989 Policy emphasis, sectors, measures
   1990 Policy emphasis, sectors, measures

7. Scenarios

	Base Case	High Growth
Agriculture	Reduce export taxes to May 1985 level	Phase out export taxes; adequate transport infrastructure
Manufacturing & Trade	Trade policy reform	Export promotion and exchange rate improvement
Energy	Oil & gas: improving extraction from existing wells; strong private sector participation in exploration and development of moderate private sector investment; Power: adequate pricing policies;	Oil & gas: Resolving COGASCO issue; building pipelines; intensive private sector investment; Power: completion of ongoing power generation;
Investment	Scale down public investment	Expand private investment

8. How realistic are policies:
   - -Trade Policy
   - -Agricutural Sector
   - -Energy Sector
   - -Financial Sector
   - -Privatization efforts
   - -Public sector management

9. Monitoring of Policies
   - -Follow Colombian model

10. Stabilization
    - -Role of the IMF

11. Financing Requirements
    - -base case
    - -high growth case

Annexes

I. Policy matrix
II. Sector Policies
III. Economic Indicators
- -Economic performance in recent years
- -Projections: Base Case and High Growth Case
  - -Key variables
  - -Financing requirements and sources
  - -Debt outstanding and disbursed by sources

JSokol:mac
12/11/85

ARGENTINA--ELEMENTS OF A POLICY REFORM PROGRAM

1. The new economic program has created confidence in the Government's management of the economy by reducing dramatically the inflation rate, cutting the overall fiscal deficit sharply, and eliminating recourse to monetary emission. Its objectives are to strengthen incentives to the private sector and streamline the public sector. It is now essential to tackle the underlying distortions and constraints in the economy in order to resume sustained rates of satisfactory real economic growth. A reform package, therefore, ought to address the following issues in order of priority, taking into account the Government's technical and political constraints in implementing it successfully.

2. Trade Regime: (a) phase out import licensing and replace it by tariffs; (b) rationalize the import tariff structure by reducing tariff dispersion; (c) simplify import and export procedures; (d) introduce automaticity in the temporary import drawback system and in foreign exchange availability for importing inputs for exports; and (e) phase out of export taxes and replace them by alternative sources of revenue such as a land tax.

3. Financial System: (a) streamline the financial system (i.e. reduce the number of banks and staff) to improve its operational efficiency; (b) strengthen the supervisory/regulatory capability of the Banking Superintendency and reporting requirements of portfolio quality of financial institutions; (c) reduce Government intervention and eliminate segmentation of credit markets; and (d) provide for the recapitalization of viable financial institutions.

4. Public Sector Finances and Investment Program: (a) rationalize the medium-term investment program consistent with a viable financing plan and sustainable macroeconomic targets. This would require scaling ongoing and prospective investments, and strengthening the screening mechanism for investment projects (i.e. selection of projects based on economic and financial criteria);strengthen tax collection and administration; and (d) reduce public investment requirements through increased private sector pariticipation.

5. Public Enterprises Management: (a) increase real prices of public services to ensure cost recovery; (b) improve mechanisms to analyze, decide, and follow up the enterprises' investment programs; and (c) allow public enterprises to operate like commercial entities.

6. Price Distortions: (a) adequate pricing of gas; and (b) improved pricing and cost recovery in such areas as road user costs, port tariffs, dredging costs, and railroad and airline tariffs; and (c) develop a suitable phase out of the price freeze.

7. Role of Public vs. Private Sector: (a) deregulation and privatization of the transport sector activities; (b) containment and increase in efficiency of military industries; (c) continue policy of awarding exploratory rights in promising oil and gas areas; and (d) where possible privatize industries under the aegis of the Ministries of Defense and of BANADE.

ARGENTINA - Points for Discussions

1. The reform process proposed is a leisurely one. Supposing we were to propose a $1 billion SAL to Argentina, with $ 500 million each in 1986 and 1987:

   a) What policy package would justify such action? How feasible is this?

   b) What is the probability of effective implementation?

   c) What is the Fund's reaction to a high-growth scenario?

   d) How does the Region see the likely reaction of the banks?

2. The alternative scenarios seem to differ only in GDP growth rates, exports and capital flows. Is this realistic? Is an identical public investment program consistent with resurgent private investment? Why should government investment stay at 7-5% of GDP in the high-growth case? What happens to domestic savings? What is total investment likely to be? What are the different expectations on efficiency (c/o ratio)? What are the assumptions on import elasticity. Additional external financing in Table 1.2 suggests a modest annual increment to external capital flows of $ 500 million per year, net. But growth is double in the high case. How sensitive is the growth rate to the external capital assumptions?

3. The alternative scenarios (page 1, Attachment IV) assumes no impact of the different policies on foreign direct investment flows or official flows. What is the explanation for that?

4. The trade policy proposals seem to consist of removing QRs and other import licenses. Why is this believed to have any impact in the absence of agreement on tariff levels. On tariff levels, only studies are contemplated with no action before 1989. What is the current average level of protection? What are the peaks? Even if one accepts the need for gradual reduction of protection, why is a uniform maximum and minimum level not negotiable? Table 2.1 shows a modest real effective exchange rate decline since 1982. But what is a reasonable parity target?

5. There are several references to domestic price controls. What do they cover? How do they operate? What bars are there, if any, to their elimination?

6. What is the foreign private investment framework in Argentina? What changes, if any, are desirable?

7. What work has been done on the public investment program? How many years does it cover? Are we satisfied with its sectoral composition? The balance between new investment and maintenance? Are there agreed investment criteria? If not, can they be negotiated? Is there central review for all public investment projects---governmental and parastatal?

Has the investment program been scaled back and, if so, on what criteria? What defines a priority project in current circumstances?

8. The reform of the public sector is said to be central issue. But, all of the measures are project or organization-oriented. What policy framework can, should be, negotiated? What is the medium-term role of the public sector in productive areas? What is to be its share of total investment? Is it agreed that it will have no preferential access to credit? That the only budget tranfers will be for equity? That operating losses will not be financed by either the Central Bank or the budget? Will the public sector have freedom to set its prices? Will management have control over wages, recruitment and dismissals?

9. There are many unclear references to monetary policy and interest rates. Is this consistent with Fund views, assuming the external resources are in sight? At what point does a less accommodating monetary policy become inconsistent with the investment and growth objectives of the High Case? If real interest rates are 50% per year (p. 1), no investment is likely to occur. Export products are unlikely to be able to earn a return justifying such a cost of capital. Consistent with a stabilization program, what measures are necessary to reduce the real rate of interest? Should a timeframe for that objective not be established? In the absence of sharply reduced real interest rates, what are the prospects for the investment objectives? Reducing spreads is an efficiency measure. Why should this be achieved by legislative diktat?