



<b>1. Project Data:</b>		<b>Date Posted :</b> 07/28/2003	
<b>PROJ ID:</b> P062992		<b>Appraisal</b>	<b>Actual</b>
<b>Project Name:</b> Argentina Special Repurchase Facility Support Loan	<b>Project Costs (US\$M)</b>	1,005.05	1,005.05
<b>Country:</b> Argentina	<b>Loan/Credit (US\$M)</b>	505.05	505.05
<b>Sector(s):</b> Board: EP - Central government administration (100%)	<b>Cofinancing (US\$M)</b>	500	500
<b>L/C Number:</b> L4406			
	<b>Board Approval (FY)</b>		99
<b>Partners involved :</b> IADB	<b>Closing Date</b>	09/15/2003	01/22/2003
<b>Prepared by :</b>	<b>Reviewed by :</b>	<b>Group Manager :</b>	<b>Group:</b>
Elliott Hurwitz	Jorge Garcia-Garcia	Kyle Peters	OEDCR
<b>2. Project Objectives and Components</b>			
<b>a. Objectives</b>			
<p>The objective of the Special Repurchase Facility Support Loan (RFSL) was to reduce the country's vulnerability to external financial shocks while maintaining its capacity for sustained and equitable growth . More specifically, the goal was to: (a) Facilitate the re-entry of Argentina into international capital markets and avoid the social and economic costs of no access; (b) protect vulnerable groups; (c) bolster the banking system's ability to withstand liquidity shocks; (d) permit continued progress in Argentina's reforms, including : savings and capital markets development; enhanced financial sector efficiency; stronger regulation; a more equitable tax and fiscal system; and more efficient social spending and investment in human capital .</p> <p>In effect, the RFSL was designed to provide supplemental resources that could comprise part of a liquidity shield robust enough to discourage large deposit withdrawals from local banks . The RFSL was linked to the Special Structural Adjustment Loan (SSAL) insofar as the <u>RFSL Loan Agreement</u> specified that RFSL disbursement was contingent on the macroeconomic framework being consistent with the objectives of the SSAL Reform Program, and on the Bank being satisfied with progress on the Program .</p>			
<b>b. Components</b>			
<p>Establish fund and administrative structure to provide emergency support to the Central Bank's (already established) Repurchase Facility (RF). This action would enable the RF to:</p> <ul style="list-style-type: none"> <li>• repurchase securities it had sold previously to international banks participating in the RF;</li> <li>• meet margin calls from banks that had purchased securities under the RF either by delivering cash or additional eligible securities;</li> <li>• buy securities during periods of no margin calls and when the Central Bank thought it advisable to replenish its stock of eligible securities.</li> </ul>			
<b>c. Comments on Project Cost, Financing and Dates</b>			
<p>The RFSL disbursed completely in September, 2001, and while the original closing date was (and remained) September, 2003, the loan account was closed in January, 2003 (since the RF and its purpose had ceased to exist). The final loan amount included US\$5.05 million to cover the up-front fee. The RFSL was a Special Structural Adjustment Loan, and in accordance with the guidelines for such loans the RFSL was to be repaid in five years with an interest rate of 400 basis points above LIBOR. Cofinancing in the amount of US\$500 million was provided by IADB.</p>			
<b>3. Achievement of Relevant Objectives:</b>			
<p>The RF was ineffective in bolstering confidence and reducing deposit withdrawals from banks, i .e., it did not achieve its principal objective. While the RF was activated by the Central Bank in September, 2001, very large withdrawals were made from banks both before and after activation . These were of a magnitude much greater than that which could be dealt with by the RF .</p>			
<b>4. Significant Outcomes/Impacts:</b>			
<p>There were no significant outcomes or impacts.</p>			

### 5. Significant Shortcomings (including non-compliance with safeguard policies):

A key assumption underlying the RFSL was that a lack of confidence in the banking system would emanate from foreign sources: "the key assumption....was that the repo facility was helping avoid or mitigate a threat from abroad, that is, the contagion effects of a global financial crisis on Argentina's financial system ." (ICR, p. 6) However, the threat to the financial system was to a large extent domestic in origin (as acknowledged in the ICR, p. 6): Starting in 1997, the deterioration of the government's consolidated fiscal balance accelerated . From mid-1997 to mid-2001, the consolidated fiscal deficit rose substantially (see section 6), and central government debt rose from around 35% of GDP to 52% of GDP.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
<b>Outcome:</b>	Unsatisfactory	Highly Unsatisfactory	The project failed to achieve any of its major relevant objectives and had no worthwhile development benefits.
<b>Institutional Dev .:</b>	Modest	Negligible	The RF has ceased to exist, and its use does not seem to have created any institutional development benefits.
<b>Sustainability:</b>	Highly Unlikely	Highly Unlikely	
<b>Bank Performance:</b>	Satisfactory	Unsatisfactory	<p>The Bank did not maintain sufficient focus on the project's development impact. While problems were identified and brought to the attention of government, appropriate solutions and follow-up actions were not taken, despite the deterioration in macroeconomic conditions.</p> <p>As of mid-2001:</p> <ul style="list-style-type: none"> <li>• The RFSL was losing the support of key banks that elected to reduce their participation in the RF;</li> <li>• A potential scarcity of eligible government bonds was identified (which would have significantly reduced the effectiveness of the RFSL);</li> <li>• Bank staff judged that activation of the RFSL would probably have resulted in costs to the government that were higher than the benefits achieved (ICR, p. 17);</li> <li>• The government's consolidated fiscal balance deteriorated. The consolidated fiscal deficit rose from around 1.5% of GDP in 1997 to 2.3% in 1998, 3.2% in 1999, 3.2% in 2000, and 6% in 2001 (data not provided in ICR). (For the period from 1997 to 2000, the MOP had projected that the consolidated deficit would range from 1.6% to 2.0% of GDP) In the first four months of 2001, the country's fiscal deficit was more than US\$4 billion, nearly two thirds of the annual target agreed with the Fund (data not in ICR). These large increases in debt were instrumental in the very large withdrawals of deposits that devastated the banking system;</li> <li>• The deterioration in its fiscal affairs between 1997 and 2001 was especially troubling because, with</li> </ul>

			<p>Argentina's currency pegged to the US dollar for nearly a decade, an excessive burden was placed on the adjustment in fiscal policy;</p> <p>The Loan Agreement specified that the project could be terminated if the macroeconomic policy framework became inconsistent with the reform program. During a supervision mission in June, 2001, the Bank raised the possibility of canceling the project in discussions with the Ministry of Finance. However, no further action in that direction was taken, and the Bank elected to keep the loan active.</p>
<b>Borrower Perf. :</b>	Unsatisfactory	Unsatisfactory	
<b>Quality of ICR :</b>		Unsatisfactory	

**NOTE:** ICR rating values flagged with '\*' don't comply with OP/BP 13.55, but are listed for completeness.

**7. Lessons of Broad Applicability:**

- If the government does not maintain a macroeconomic framework conducive to the achievement of project objectives, the Bank should consider taking prompt remedial action, including project termination and cancellation of undisbursed balances
- When macroeconomic policies create large economic imbalances, a repo facility has little chance of calming the fears of depositors and investors because by itself it cannot restore economic stability

**8. Assessment Recommended?**  Yes  No

**Why?** Lending to "provide exceptional support....for countries approaching a potential crisis" (Guidelines for Special Structural Adjustment Loans) is relatively new for the Bank, and it would be beneficial to draw lessons from the efforts undertaken thus far.

**9. Comments on Quality of ICR:**

The ICR is unsatisfactory. It fails to provide adequate evidence to support ratings in the areas of outcome, institutional development impact, and Bank performance. The ICR is long, yet omits macroeconomic data critical to project evaluation (such as that presented in sections 5 and 6). The ICR also does not present evidence to justify the assertions that "the RFSL played a satisfactory dissuasive role while the perceived dominant risk was contagion from external financial turmoil." The ICR also does not present a discussion of any follow-up to the potential "violation of the BCRA policy commitment" when the RSFL was used beyond its original intent (ICR, p. 13).

The ICR does not substantiate assertions that "international financial markets discriminated against Argentina," and that Argentina was "singled out" in the flight to quality in 2001. After a substantial appreciation of the currency, a sharp drop in exports to its main trading partner, and a deteriorating fiscal position, it is not surprising that sovereign spreads for Argentina increased dramatically. In September, 1999, Argentina was 165 basis points above the average sovereign spread of 38 emerging nations. By September, 2001, Argentina was 1,500 points above the average for the 38 countries. Given the elements noted above, it is not reasonable to interpret this very large increase in sovereign spreads as simply reflecting discrimination.