

International Bank for Reconstruction and Development
International Development Association
International Finance Corporation
Multilateral Investment Guarantee Agency

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EDS2000-212
June 26, 2000
04:16:55 PM

Statement by Valeriano F. García
Date of Meeting: June 27, 2000

Argentina - Country Assistance Strategy (R2000-116 - IFC/R2000-120)

We congratulate staff for a comprehensive CAS for Argentina. The strategy was built after ample consultations with different groups, representing a balanced cross-section of opinions and expertise. More than 4,000 civil society leaders (from NGOs, trade unions, community-based organizations, academia, research centers, religious groups, the business community and private foundations) sat together with senior Bank officials in five forums held across the country, and a national forum in Buenos Aires. They discussed papers on various sectors (including transportation, the financial sector, the judicial system, education, and the health sector). The consultations were co-hosted by a panel of organizations whose mandate is to analyze the Bank's role in Argentina. Consultations with the government took place in a period of political transition, but the CAS reflects the priorities of the Argentine government.

1. General Remarks

•Market Access

“We have to reaffirm unambiguously that open markets are the best engine we know of to lift living standards and build shared prosperity.” President Clinton (World Economic Forum). In our opinion, it would have been valuable to put more emphasis in this CAS on the crucial importance of enhanced international market access.

•Corruption

Although it is mentioned in the CAS that Argentina rates significantly below some of its neighboring countries when it comes to transparency, accountability and corruption in the public sector, maybe this statement, based mainly on perceptions, could be revised. Consequently, we would ask management to reconsider including this assertion in the final version.

•Poverty

The document rightly emphasizes the need to reduce vulnerability of the economy to external shocks in order to avoid the poverty-creation effect of economic crises. It also emphasizes the success of targeted approaches to poverty alleviation and the need to continue with improvements in health and education. The CAS points out that “*Argentina has experienced widening gaps in wages paid to those with modern skills and a stagnation in wages paid to those with low skills*”. In this case the market is signaling the importance of training in modern skills. The very serious problem of those people lagging behind because they hold inadequate skills should be addressed through targeted programs of social protection that include an important component of training. In this respect, the Argentine authorities and the Bank share the same strategy.

- IFC in Argentina and in Poorer Countries

Regarding IFC, we welcome the fact that the high profitability of its Argentine portfolio has allowed it to take riskier projects in poorer economies. IFC’s role in developing capital markets in Argentina and investing in education has had a high impact on development. We would welcome, however, a deeper IFC involvement in the poorest Provinces of the country. This would help leverage the IBRD efforts to achieve a more balanced country growth.

- Income Thresholds: Level and Variance

The CAS rightly points out that Argentina is a diverse country and that its high *average* income per-capita hides a striking *variance*. So much so, that almost 30% of the people and 40% of their children are defined as poor. While some people from the Argentine mid-region may have per capita incomes similar to those in the most developed countries and a lifestyle that may surprise the occasional visitor, other people—mostly in the northern provinces—suffer poverty indexes so acute that they would dismay and confuse the same occasional visitor.

2. The Macroeconomic Situation. President de la Rúa, in his recent trip to Washington D.C., stated: “*I wish to ratify our commitment to the convertibility regime and to maintaining key policies for the economic stability of the country. We are convinced that counting with a sound currency is an essential condition for growth and individual progress.*” In the year 2000, Argentina entered into its tenth year with a currency board and the “convertibility law” continues to enjoy popular consensus and unflagging government support. The macroeconomic and growth strategy emphasizes deregulation of labor markets and civil service reform, fiscal discipline through both tax and expenditure reforms—including agreements with the provinces—more open competition in the communication and transport sectors, strengthening Mercosur, sustaining the soundness of the financial sector, and assuring, on a timely basis, full transparency of all economic data and official statistics.

Last year’s economic performance was heavily influenced by the Asian and Russian financial crises, the deterioration of the terms of trade, the significant real devaluation of the Brazilian currency and the subsequent increase in the spreads for Argentine bonds. This risk premium also affected domestic interest rates. As a consequence of these external shocks, the Argentine economy weakened substantially, and we are still experiencing the effects of such a difficult exogenous environment.

Recession was reflected in deflation, with both the CPI and the GDP deflator dropping by almost 2% and 2,5%, respectively. Total exports decreased by 11.8% in 1999, to US\$23.3 billion. Total imports fell by 18.7%, to US\$25.5 billion, in the same year. Argentina also experienced a sharp decline in the terms of trade, caused by higher oil prices and lower agricultural commodity prices. During 1999, exports to Mercosur countries (30.2% of Argentina's total exports in that year) plunged 25.2%, primarily due to decreasing exports to Brazil. Imports from Mercosur countries—which amounted to US\$14.4 billion (24.6% of Argentina's total imports in that year)—fell by 20.6% compared to 1998. The recession reduced the trade deficit to US\$2.2 billion in 1999, from nearly US\$5 billion in 1998.

The current account deficit was lowered to almost 4.1% of GDP in 1999—from 4.9% of GDP in 1998—while more than half of it was financed by FDI. Lower internal demand and a decrease in exports to Brazil caused a decline of 7.0% in industrial production during 1999. In this context, unemployment rose on that year. The government is trying to neutralize both the cyclical and the structural components of our high unemployment.

Congress approved during the second week of May 2000 President de la Rúa's bill proposing labor reforms, which include the following:

- extending the trial period for newly hired workers;
- reducing certain taxes on labor over four years;
- putting off automatic renewal of collective labor agreements when employees and employers cannot agree on the terms of new collective agreements; and
- decentralizing negotiation of collective agreements in order to allow collective bargaining at company level.

The bill, to which the Bank contributed substantially through a succession of reports, seeks also to grant additional powers to the government in order to facilitate reduction of the fiscal deficit. By reducing the fiscal deficit, the real interest rate would be reduced, investment incremented and economic activity improved.

3. One of the primary goals of President de la Rúa's administration is to trim down Argentina's fiscal deficit. In 1999 Argentina recorded a fiscal deficit of US\$7.1 billion, excluding privatization proceeds. This deficit was primarily due to a decrease in tax revenues, caused by recession. On December 29, 1999, Congress approved a government-sponsored tax package designed to raise tax collections by an additional US\$1.9 billion for the year 2000. On December 28, 1999, Congress approved Argentina's year 2000 budget, which assumes a real GDP growth of 4.0%, a 1.6% increase in prices of goods and services, and a fiscal deficit of US\$4.5 billion, on a cash basis and including the surplus of the Central Bank. It also includes government proposals to reduce expenditure by US\$1.4 billion and to limit federal tax transfers to the Provinces. Furthermore, on May 29 the government introduced a severe cut in public expenditures, which included a reduction in nominal salaries of public employees, in an unprecedented effort to further reduce the fiscal deficit and meet IMF targets.

The assumed deficit conforms to the Fiscal Solvency Law of 1999. This Law sets the rules for public spending restrictions and enforces a schedule for a gradual reduction of the fiscal deficit in the next few fiscal years. The Law sets forth that expenditure and public sector deficit will be kept under control while creating a Fiscal Stabilization Fund that will be capitalized with 1 to 2% of tax collections, and with any fiscal surplus available.

4. Despite the fact that external conditions continued to be very difficult, the public has remained confident in the banking system, and deposits are still growing. Argentina has a strong banking system; its regulatory frame is sound, based on the following:

- high liquidity requirements (20% for deposits);
- contingent loan for systemic crises (a repo facility for US\$7 billion);
- capital adequacy of 11.5% of risk assets (above the Basle level, suggested at 8%);
- obligation for banks to submit to ratings by international agencies and make the results public; and
- introduction of subordinated debt to improve supervision (market-based indicator).

As of May 19, 2000, total deposits (43.4% of which were in Argentine pesos and the rest in foreign currency) in the banking system equaled US\$86.2 billion, almost 4% increase from December 30, 1999. Moreover, it is noteworthy that Argentine international reserves have attained a historical peak of around US\$27.0 billion.

5. The government is trying to stabilize the growth of public debt and to reduce its ratio to GDP. As of December 31, 1999, total gross public debt was US\$121.9 billion. Approximately US\$113.8 billion (93.3%) of this amount were denominated in currencies other than the peso (mainly U.S. dollars). As of December 31, 1999, total net public debt (total gross public debt minus total government financial assets related to debt operations, such as the U.S. Treasury Bills held as collateral for Brady bonds) was US\$110.9 billion.

6. On March 10, 2000, the IMF approved a three-year credit facility of US\$7.4 billion for Argentina. The terms of this credit facility require Argentina to meet specific targets with respect to economic growth and the reduction of its fiscal deficit. It replaces the US\$2.8 billion credit facility approved by the IMF on February 3, 1998.

During 1999, Argentina raised US\$23.4 billion—including US\$3.8 billion earmarked for debt buy-backs—completing its funding needs for 1999. The US\$23.4 billion include:

- US\$1.4 billion in financing from the World Bank and the IADB;
- US\$11.9 billion of debt issued in the form of US dollar-denominated global bonds, euro-denominated bonds and yen-denominated bonds;
- US\$7.8 billion of debt issued in the domestic market in the form of Bonos del Tesoro, Pagaré-Bonos and a net increase in the stock of Letras de Tesorería, and;

- US\$2.3 billion from privatization, including the sale of Argentina's remaining stake in YPF, the national Oil Company.

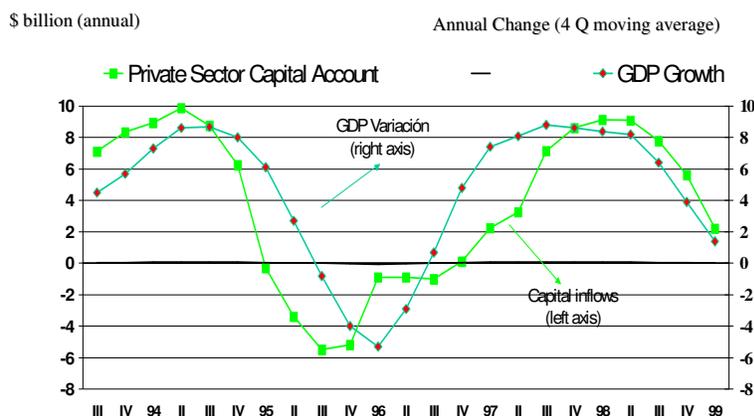
During the first quarter of 2000 Argentina issued (or received commitments for) US\$6.1 billion of debt, which include:

- US\$2.7 billion of debt issued in the form of US dollar-denominated global bonds;
- US\$1.9 billion of debt issued in the form of euro-denominated bonds; and
- US\$1.5 billion of debt issued in the domestic market in the form of Bonos del Tesoro, Pagaré-Bonos and a net increase in the stock of Letras de Tesorería.

Argentina debt management has been very professional. Recently the Par and Discount bonds were exchanged for a new Global 2015. The US\$3.3 billion operation implied substantial savings for the Treasury. With this transaction the country covered its financial needs until next August. At the same time, releasing the guarantees of T-Bonds of each title for capital and two interest payments generated an extraordinary US\$486 million in additional income.

7. Summing up, Argentina has excellent macroeconomic indicators, even by very stringent standards. However, the country is still vulnerable to macroeconomic shocks. This can be seen in the following chart:

Private Capital Inflows and GDP Growth



The chart shows that the business cycle is closely related to capital flows. The government strategy is to smooth out these cycles by strengthening its fiscal accounts, maintaining the soundness of its financial sector and reaffirming its commitment to the currency board. This policy will reduce country risk and, consequently, the level and the volatility of domestic interest rates, cutting down short-term hot capital and increasing domestic investment expenditure. The domestic savings schedule would shift to the right due to reduction in the fiscal

burden. This strategy is also coupled with measures to make the economy more flexible in order to work out the adjustment through prices, instead of through employment and the real economy.

8. On Poverty. Lending operations are aimed at high priority areas, and we agree with the priorities specified in this CAS. Poverty and unemployment alleviation loans have been very well targeted. Loans related to maternal/child care have been quite successful. Infant mortality has decreased, and great part of this success must be credited to the Bank and the government efforts in this area.

9. On Cost Effectiveness. We would like to underline that the Bank’s financial assistance to Argentina during the 90s is placed among the best Bank-wide, and that it reports an improvement over the years: satisfactory outcomes stand at 98% (FY91-99), as opposed to 39% for FY68-90. Compared with other countries, Argentina’s program is also very cost-effective: Bank-wide the cost per project reaches US\$981 (the cost per US\$1000 of net commitment is US\$13.5), while for Argentina it is around US\$621 (the cost per US\$1000 of net commitment is US\$3.8), the lowest for the LAC region.

10. The Bank's assistance for decentralization of health and education was the watershed for an ample social reform program. Health programs include maternal, child health and nutrition projects, and they have helped reduce infant mortality rates in recent years. The Health Insurance Reform Project (FY96) has also been quite successful in speeding up competition in the market. Programs for secondary education (FY95 and FY96), managed by the Provinces, have been well targeted on the poor and are aimed at teacher and management training, curricular reform and technological assistance.

We would like to stress the importance of the technical assistance and advice provided by the Bank. The mining sector review in 1993 and subsequent assistance (US\$30 million in FY96 and US\$39.5 million in FY98) helped identify the conditions required for expansion of the sector to compete at the international level (laws, regulations, and development of geological and mineral data, etc.). Mining—in part thanks to this start-up facilitation—was booming in Argentina until the fall of international commodity prices last year.

11. On Negative Flows. Last, but by no means least, we wish to emphasize the important reduction in the Bank projected lending for Argentina. Table 1 shows that the estimated pattern of Bank’s disbursements for the next fiscal years would impose severe constraints on the Treasury and, consequently, severe constraints to sustain structural reforms and to protect social programs.

Table 1
Disbursements and Amortization
 Estimated Projections for FY00-04
 -Millions of \$-

<i>CONCEPT</i>	FY00	FY01	FY02	FY03	FY04
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<i>a. Disbursements</i>	1456	1557	1134	1287	1096
<i>b. Amortization</i>	664	1981	1267	762	794
<i>c. Interest Payments</i>	752	808	778	769	805
<i>Net Transfers (a+b+c)</i>	40	-1232	-911	-244	-503

Negative net transfers become quite significant in the next fiscal year and continue through FY04. For a country vulnerable to volatile financial markets, these figures look really troublesome. We expect the Bank to be flexible if world capital markets make it difficult for Argentina to access them again.

My authorities would like for the triggers leading to the high case scenario to include, besides the issue of Federal-Provincial fiscal co-participation, other very important areas of reform. Support for further reforming the social security system is crucial in a context where many employees are working without adequate pension prospects. The health system protection for the elderly also needs to continue its reform agenda. Moreover, enhanced competitiveness is a critical matter for Argentina, and deregulation in particular in matters related to the area of communications is of great importance to reduce costs and make the Argentine economy grow in a sustainable way.

Finally, I am attaching a letter sent by Minister José Luis Machinea, Minister of Economy of Argentina, to President Wolfensohn, regarding Argentina and the CAS.

BUENOS AIRES, Junio 22 de

2000

*Sr. James D. Wolfensohn Presidente Banco Mundial ,
Washington, D.C.*

Estimado Sr. Wolfensohn;

Tengo el agrado de dirigirme a usted con relación a su memorando de fecha 24 de mayo pasado, referido al documento de Argentina "Estrategia para la asistencia al país"

(Country Assistance Strategy), el cual será motivo de consideración por parte del Directorio Ejecutivo de vuestra Institución el próximo martes 27 de junio.

En primer lugar, deseo agradecerle a usted, a los expertos del Banco y a todas aquellas personas que han contribuido y participado en la elaboración de dicho documento. El mismo es el resultado de un extenso proceso de consultas, que ha incluido no sólo a funcionarios gubernamentales sino también a distintos grupos de nuestra sociedad civil.

Su atenta nota nos brinda una excelente oportunidad para comentar acerca de la forma en que vemos el futuro de la relación de Argentina con el Banco. En primer lugar, quisiera enfatizar nuestro acuerdo con el impulso general de la estrategia, En particular, apoyamos el énfasis en el desarrollo social, el mejoramiento del desempeño del sector público, especialmente a nivel subnacional, y la consolidación de las reformas estructurales.

El Gobierno de Argentina desea destacar la importancia del apoyo del Banco para consolidar sus esfuerzos en fortalecer las finanzas públicas y aumentar la competitividad de la economía. El Presidente de la Rúa se encuentra comprometido con esos objetivos desde el comienzo de su mandato el 10 de diciembre de 1999. El gobierno considera que estos temas son una condición esencial para el crecimiento y, consecuentemente, una condición necesaria para lograr equidad social.

La razón primordial de este especial énfasis señalado proviene del hecho de que a pesar de las importantes reformas llevadas a cabo en diferentes sectores de la economía durante la última década, el sector público no ha logrado todavía un balance sostenible. Más aún, la situación externa de Argentina que, tal como señala correctamente el informe del Banco es un motivo de atención constante, tiene sus raíces en incrementos previos en el gasto público y en la acumulación de desequilibrios fiscales que ocurrieron durante gran parte de los años noventa. Estos desarrollos fueron ocultados por condiciones favorables que generaron un rápido aumento de la actividad económica, y por un vasto programa de privatizaciones que proveyeron recursos fiscales. En la actualidad, con un panorama internacional diferente y en ausencia de ingresos extraordinarios para el sector público, emergen con claridad las restricciones a las que se enfrenta la actual administración.

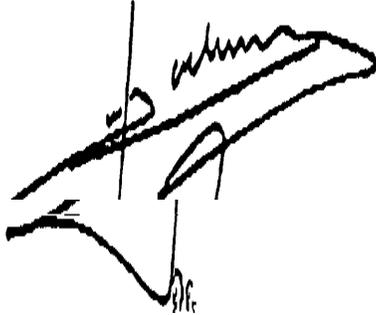
Es en este contexto que el gobierno considera que la relación de nuestro país con el Banco no debe experimentar cambios significativos en nuestro próximo programa operativo. La pobreza aún se encuentra extendida en Argentina y el nivel del ingreso medio per cápita oculta pronunciadas diferencias regionales en la distribución del producto y la riqueza. En tal sentido, deseamos compartir con usted la necesidad de encarar el programa operativo del próximo trienio con un criterio amplio. Esperamos, en tal sentido, contar con el apoyo del Banco para consolidar los logros ya obtenidos y para acompañar la agenda de la actual administración.

Quisiera destacar que la participación relativa de las operaciones de financiamiento de nuestro país con los organismos multilaterales de crédito y en particular con el Banco Mundial, están disminuyendo en forma gradual y paulatina al tiempo que aumenta nuestro acceso a los mercados financieros.

En respuesta a la consulta respecto de la difusión de este informe, a través de la presente le comunico nuestra autorización, y mucho agradeceré que la eventual difusión incluya el texto de esta carta.

Le he solicitado a nuestro Director Ejecutivo en el Banco la lectura de esta carta cuando el documento del CAS sea sometido a consideración del Directorio Ejecutivo de la Institución.

Sin otro particular, saludo a Usted atentamente,

A handwritten signature in black ink, appearing to read 'Machinea', written over a horizontal line. The signature is fluid and cursive.

DR. JOSE LUIS MACHINEA

Free translation

Washington, D.C., June 22, 2000

Mr. James D. Wolfensohn
President
The World Bank Group
Washington, D. C.

Dear Mr. Wolfensohn:

I am pleased to refer to your memorandum dated May 5 concerning the document “Argentina - Country Assistance Strategy”, which will be submitted to consideration of the Bank’s Board of Directors next Tuesday, June 27.

In the first place, I would like to thank you and the Bank team that elaborated this document. This CAS is the result of an extensive consultation process, which included not only government officials, but also a large canvas of our civil society.

Your letter provides us with an excellent opportunity to comment on the way we see the future of the Argentina-Bank relationship. I wish to emphasize our agreement with the general thrust of the strategy. In particular, we agree with the emphasis on social development, on the improvement of public sector performance—especially at sub-national level—and on the consolidation of structural reforms.

The Government of Argentina also wishes to highlight the importance of the Bank’s support to consolidate its efforts to strengthen public finances and improve economic

competitiveness. President de la Rúa is committed to these objectives since the beginning of his mandate on December 10, 1999. His administration considers that these issues are an essential condition for growth and, consequently, a necessary condition to achieve social equity as well.

The main reason for this special emphasis stems from the fact that, despite important reforms carried out in the last decade in different sectors of the economy, the public sector has not as yet reached a sustainable equilibrium. Moreover, the external situation of Argentina that—as rightly pointed out in the Bank’s report—is a reason of permanent concern, takes its roots from previous increases in public expenditure and the accumulation of fiscal imbalances that occurred during great part of the 1990’s. These developments were concealed by favorable conditions that generated a swift increase in the economic activity, and by a widespread privatization program that provided fiscal resources. Today, under a different international panorama and in the absence of extraordinary revenues for the public sector, the constraints faced by the present administration emerge in all clarity.

In this context, our government considers that the relationship of our country with the Bank should not experience significant changes in our next operational program. Poverty is still widespread in Argentina and the average per capita income conceals striking regional differences in the distribution of products and wealth. In this sense, we wish to share with you the need to face the operational program of the next triennium with an open mind. We hope to count with the Bank’s support to consolidate the achievements already attained and to complement the agenda of the present administration.

I would like to stress the fact that the relative participation of our country in financing operations through multilateral credit organizations, particularly the World Bank, is decreasing gradually, while our access to financial markets is increasing.

In response to the consultation regarding disclosure of this report, I am herewith conveying our authorization, and I would greatly appreciate your including the text of this letter in it.

I have asked our Executive Director to read this letter at the time the CAS document is submitted to the consideration of the Bank’s Board of Directors.

Very truly yours,
Jose Luis Machinea
Minister of Economy and Finance