Report No. 6467-AR

Argentina
Economic Recovery and Growth

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Latin America and the Caribbean Region

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CURRENCY EQUIVALENTS

Currency Unit	-	Austral (A)
Exchange Rate Effective March 30, 1987		
US$1.00	-	1.541 Austral
1.00 Austral	-	US$0.649
A 1,000,000	-	US$649,000

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ECONOMIC MEMORANDUM ON ARGENTINA

ECONOMIC RECOVERY AND GROWTH

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PREFACE

This report is based on the findings of a mission that visited Argentina in April 1986. The mission was comprised of:

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This document provides a brief overview of the mission's findings. The mission's main focus was on the macro environment and did not deal with many important sectors such as agriculture, mining and construction.

Since the mission the Government has carried out a number of significant policy reforms especially in trade policy and the public sector. These are in line with some of the report's recommendations and in such instances this report should be viewed as supportive of Government initiatives.

GLOSSARY OF ACRONYMS

AACRE	Asociacion Argentina de Consorcios Nacionales de Experimentacion Agricola	Argentine Association of Regional Experimental Consortia
ADMIRA	Asociacion Metalurgica Argentina	Argentine Metallurgic Association
ANA	Administracion Nacional de Aduanas	National Customs Administration
BANADE	Banco Nacional de Desarrollo	National Development Bank
BCRA	Banco Central de la Republica Argentina	Central Bank of Argentina
BONAVI	Bonos Nacionales de Intereses Variables	Variable Interest Rate Bonds
BONEX	Bonos Externos	Foreign Bonds (US dollars denominated Government Bonds)
CEM		Country Economic Memorandum
CEN	Corporacion de Empresas Nacionales	Corporation of National Enterprises
CEPAL	Comision Economica para Latinoamerica	Economic Commission for Latin America (ECLA)
CD	Certificado de Deposito	Certificate of Deposit
CGIAR/CGR		Consultative Group on International Agricultural Research
CGT	Confederacion General de Trabajo	General Confederation of Workers
CKD		Completely Knocked Down
CONADE	Consejo Nacional de Desarrollo	National Development Council
CPI		Consumer Price Index
CRM	Cuenta de Regulacion Monetaria	Monetary Regulation Account (Interest Equalization Fund)
DGI	Direccion General Impositiva	General Tax Directorate
DIF		Deposit Insurance Fund
DJAT	Declaracion Jurada de Admision Temporaria	Temporary Admission Import Request
DJNI	Declaracion Jurada de Necesidades de Importacion	Import Permit
DNPC	Direccion Nacional de Promocion Comercial	National Directorate of Commercial Promotion
FIEL	Fundacion de Investigaciones Economicas Latinoamericanas	Latin American Foundation for Economic Research
FUNDECO	Fundacion Economica	Economic Foundation
GATT		General Agreement on Trade and Tariff
GDP		Gross Domestic Product
GDFI		Gross Domestic Fixed Investment

IBRD		International Bank for Reconstruction and Development
IDB		Interamerican Development Bank
IFS		International Financial Statistics
IICA	Instituto Interamericano de Cooperacion Agricola	Interamerican Institute for Agricultural Cooperation
IMF		International Monetary Fund
INDEC	Instituto Nacional de Estadistica y Censo	National Institute for Statistics and Census
INPE	Institute Nacional de Planeamiento Economico	National Economic Planning Institute
INTA	Instituto Nacional de Tecnologia Agropecuaria	National Institute for Agricultural Technology
JNC	Junta Nacional de Carnes	National Meat Board
JNG	Junta Nacional de Granos	National Grain Board
LIBOR		London Interbank Offer Rate
NADE	Nomenclatura Arancelaria de Exportacion	Customs Classification for Exports
PRESEX (PEX)	Programas Especiales de Exportacion	Special Export Program
RER		Real Exchange Rate
REER		Real Effective Exchange Rate
SIC		Standard Industrial Classification
SIGEP	Sindicatura General de Empresas Publicas	General Comptroller of the Public Enterprises
SITC		Standard Industrial Trade Classification
SKD		Semi-knocked Down
SMI		Small and Medium Industry
SNESR	Servicio Nacional de Economia y Sociologia Rural	National Rural Economic and Sociological Service
TAR		Temporary Admission Regime
VAT		Value-Added Tax
VNA	Valores Nacionales Ajustables	Indexed National Bonds
WPI		Wholesale Price Index
YPF	Yacimientos Petroliferos Fiscales	State Oil Company

COUNTRY DATA - ARGENTINA

AREA	POPULATION 8/	DENSITY 1/
2766.9 thous. sq km.	31.1 million (1986) Rate of Growth: 1.6	10.7 per sq. km. 16.9 per sq. km. of arable land

POPULATION CHARACTERISTICS 1/

Crude Birth Rate (per 1000)	23.6
Crude Death Rate (per 1000)	8.9
Infant Mortality (per 1000 live births)	34.4

HEALTH 2/

Population per physician (thous.)	0.5
Population per hospital bed (thous.)	0.2

INCOME DISTRIBUTION 2/

% of national income, highest quintile	50.3
lowest quintile	4.4

DISTRIBUTION OF LAND OWNERSHIP

% owned by top 10% of owners	..
% owned by smallest 10% of owners	..

ACCESS TO SAFE WATER (1980)

% of population - urban	65.0
rural	17.0

ACCESS TO ELECTRICITY (1980)

% of population - total	87.0

NUTRITION 1/

Calorie intake as % of requirements	119.2
Per capita protein intake (grams per day)	99.7

EDUCATION

Adult literacy rate %	93.0 3/
Primary school enrollment %	107.0 1/

GNP PER CAPITA IN 1986: US $ 2153 4/

GROSS NATIONAL PRODUCT IN 1986 8/ / **ANNUAL GROWTH RATES (%, const. prices)**

	US $ Mln.	% of GNP	1970-75	1975-80	1980-85	1986 8/
GNP at market prices	66061.1	100.0	2.9	1.8	-3.4	7.1
Gross Domestic Investment	8257.6	12.5	1.9	4.4	-16.2	18.5
Gross National Savings	7487.9	11.3	0.5	2.0	-13.8	-7.0
Current Account Balance	-2645.0	-4.0				
Exports of Goods & NFS	8797.0	13.3	-4.7	14.1	5.2	-8.6
Imports of Goods & NFS	7025.0	10.6	0.6	13.3	-13.0	16.9

OUTPUT, LABOR FORCE AND PRODUCTIVITY IN 1986 8/

	Value Added		Labor Force 5/		V.A. Per Worker
	US $ Mln.	%	Thous.	%	US $
Agriculture	10637.0	15.2	1334	12.0	7970.9
Industry	25192.8	36.0	3488	31.4	7222.5
Services	34150.2	48.8	6277	56.6	5440.7
Total/Average	69980.0	100.0	11099	100.0	6304.9

GOVERNMENT FINANCE

	Consolidated Public Sector			Central Government		
	Au$ Mln.	% of GDP		Au$ Mln.	% of GDP	
	1985	1985	1983-85	1985	1985	1983-85
Current Receipts	10712	27.0	24.5	6666.5	16.8	16.1
Current Expenditures	10077	25.4	25.8	4146.6	10.5	10.6
Current Balance	635	1.6	-1.3	2519.9	6.4	5.5
Capital Expenditures	2420	6.1	6.7	645.3	1.6	1.6
Surplus or Deficit	-1746	-4.4	-7.9	2176.8	5.5	4.5
External Financing (net)	436	1.1	1.4	489	1.2	1.0

COUNTRY DATA - ARGENTINA

MONEY, CREDIT AND PRICES

	1980	1981	1982	1983	1984	1985	1986
	(Millions of Au$ outstanding end of period)						
Money and Quasi Money	8.6	16.0	38.3	193.6	1195.3	7337.9	..
Bank Credit to Public Sector	2.8	10.8	34.8	212.3	994.9	1640.1	..
Bank Credit to Private Sector	8.3	22.2	68.9	290.8	1822.4	9398.3	..
Money and Quasi Money as % of GDP	30.4	29.3	29.4	28.4	22.6	18.5	..
Wholesale Price Index (1981=100)	47.9	100.0	357.3	1646.8	11093.0	84820.7	138982.2
Annual percentage changes in:							
General Price Index	75.4	109.0	257.3	360.9	573.6	664.6	63.9
Bank Credit to Public Sector	0.3	385.2	322.2	610.1	468.6	164.9	..
Bank Credit to Private Sector	0.2	266.0	310.4	422.1	626.7	515.7	..

BALANCE OF PAYMENTS

	1975	1980	1986 8/
	(Millions of US$)		
Exports of Goods, NFS	3704	10765	8797
Imports of Goods, NFS	4518	14024	7025
Resource Gap (deficit = -)	-814	-3259	1772
Interest Payments (net)	-460	-947	-3938
Other Factor Payments (net)	-15	-584	-484
Net Current Transfers	5	23	5
Balance on Current Account	-1284	-4767	-2645
Direct Investment	..	788	574
Public M&LT Loans (net)	-12	3400	762
Disbursements	1018	5809	3134
Amortization	1030	2409	2372
Subtotal	-12	3400	762
Other Capital (net)	189	-2217	487
Changes in Reserves (- incr	1107	2796	822
Gross Reserves (end year)	618	7288	3927
Net reserves (end year)	-520	6641	-9998

MERCHANDISE EXPORTS (AVERAGE 1984-1986)

	US $ Mln.	%
Agricultural goods	3462.7	44.2
Manuf. goods of agric. orig	2545.7	32.5
Manuf. of industrial origin	1821.3	23.3
Total	7829.7	100.0

EXTERNAL DEBT, DEC. 31, 1986

	US $ Mln.
Public Debt	40496
Private Debt	8578
Total Outstanding & Disbursed	49074
IBRD	896
IDB	1368
IMF	2326
Bilaterals	3140
Bonds	3354
Commercial Banks	37990

DEBT SERVICE RATIO FOR 1986 6/

DEBT SERVICE RATIO FOR 1986 6/	75.9
Interest service ratio	48.8

RATE OF EXCHANGE 7/

1980

US $ 1.00 = Au $ 0.00018
Au $ 1.00 = US $ 5555.6

1986 8/

US $ 1.00 = Au $ 0.94303
Au $ 1.00 = US $ 1.06041

IBRD/IDA LENDING, DECEMBER 31, 1986 (Mln. US $)

	IBRD	IDA
Outstanding & Disbursed	896	-
Undisbursed	986	-
Outstanding incl. Undisbursed	1882	-

1/ Between 1982 and 1985.
2/ Between 1970 and 1976.
3/ 1978.
4/ Estimate. Bank Atlas methodology.
5/ Calculated by applying 1980 ratios of sectoral categories to total population to 1986 estimated population.
6/ Excludes arrears and amortization of short-term debt; includes rescheduling of debt.
7/ Year average.
8/ Preliminary.

EXECUTIVE SUMMARY

i. In recent decades Argentina has failed to realize its economic potential. Among countries, its ranking in terms of GDP per capita has fallen steadily from among the most developed to close to the median. Economic policy has changed erratically as it was buffetted by conflicting demands in a pluralistic society. The democratic government of President Alfonsin, which came to power in late 1983, was faced by an economy in disarray, a large external debt, and a number of political difficulties.

ii. Following the failure of some attempts to stabilize the economy through orthodox (primarily demand management) policy measures, the Plan Austral was introduced in June 1985. This combined some heterodox measures such as wage and price controls with more traditional measures such as reduction of the public sector deficit and a more favorable exchange rate to improve external and domestic balances.

iii. The measures taken included tighter monetary and fiscal controls, positive real interest rates to encourage savings and stem capital flight, and later the introduction of a crawling peg regime to ensure a more competitive exchange rate. Steps were taken to improve the management of public sector enterprises by appointing technocrats as managers and strengthening government regulatory agencies and their oversight.

iv. By the first quarter of 1986, relative success on the inflation front and initial attempts to improve export performance and redefine the role of the public sector were tempered by a poor medium-term outlook for economic growth. This was because many reforms remained to be undertaken while tangible gains from policies directed towards improving export prospects and stimulating private sector activity were slow in coming. The reforms undertaken were largely supply side initiatives and even with these changes it simply takes time to change a deep rooted way of thinking and doing business. They were further hindered by adverse changes in terms of trade.

v. In March 1986, the Government decided to relax the price freeze and move to a system of administered prices. This was followed in April by introducing a series of mini-devaluations of the Austral. Prices began to rise again in mid-year reaching a monthly rate of 8.8%. At the same time, increased credit availability facilitated a strong recovery of the real economy so that in the third quarter of 1986 real output was up 11.8% over the corresponding quarter of 1985. Within this the industry and manufacturing sector was up 26.5%. In late August the authorities moved to a restrictive monetary policy, higher public sector prices and reversing some of the relaxation of price controls. This had the desired effect on inflation with the CPI and WPI changes falling to 4.7% and 3% for December. However, real interest rates were driven up creating problems for industry.

vi. In November/December 1986, monetary policy became more accommodating and in January the CPI reached 7.6%. Accordingly, in February 1987, the Government introduced another package with the aim of stemming the resurgence of high inflation and reactivating the economy. The package included a devaluation of the Austral by 6.6% and wage/price freeze. The latter was presented as a temporary measure to help stabilize the economy and give some time to progress with the structural reforms especially in trade, finance, and the public sector. The wage freeze was set until June 1987 while the price freeze was sine die to preclude speculative behavior.

vii. As policies of structural adjustment to support medium-term growth are extended and strengthened, it is expected that the economy will revive. This revival is expected to result from a number of factors. These include structural reforms in trade, financial sector, public sector and some form of "social contract" to ensure acceptable labor policy. The changes needed would be facilitated by efficiency gains where Argentina has substantial room for improvement. There would be a steady but realistic increase in investment. Historically, much of the private sector investment in Argentina has tended to either follow or accompany the public sector. Current high interest rate levels are also a strong deterrent. On the export side, the industrial sector will take time to adjust to exports in a significant way after 20 to 30 years of accommodation to a highly protected domestic market interrupted briefly by ill-conceived import liberalization in the late 70s. At the same time the agriculture sector, which is quite efficient, finds itself stymied by closed markets, unfavorable prices and restrictions on international competition.

viii. There are three central recommendations to complement the broad thrust of structural reform: (a) a moderate increase in investment with non-inflationary financing; (b) a resource mobilization strategy; and (c) reforms to improve the milieu of business. It is expected that the private sector will be a primary beneficiary of structural reform.

ix. Until the business climate has improved, the report recommends a carefully targetted and moderate increase in investment. This would increase the consolidated public investment share from 6.1% of GDP (1985) to 6.6% of GDP (1987) but would still be substantially below levels of the last decade. This is in line with the Argentine program supported by an IMF Agreement, though slightly larger, i.e., including a 1% increase over the 1986 level vs. a 0.7% increase in the IMF program. It would be financed primarily by an increase in net external capital inflows, increasing the yield of some taxes such as the value-added tax while at the same time cutting costs in state enterprises. The increased availability of net capital flows should initially be directed at carefully chosen areas in public sector investment to begin the process of modernizing the physical and social infrastructure of the nation while seeking to alleviate critical bottlenecks to recovery and growth. They should be directed to areas which could quickly achieve cost recovery and generally command a broad political consensus such as telecommunications/postal system, ports, and selective social sectors.

x. The report also indicates a number of possibilities to increase resource mobilization and improve the milieu for business. These include a country equity fund, export financing facility, rationalization of the role of the public sector and schemes to modify the debt burden such as debt equity arrangements and lease back arrangements for new investments. These measures would be complemented by initiatives to stimulate industrial development and exports and rationalize the labor markets. The net effect of these measures is expected to result in a stronger private sector participation in the economy.

xi. The focus of the report is on policy reform with the central issue being resumption of growth without reigniting inflationary pressures. It seems inevitable that the Government will need to be prepared to handle any incipient inflation in a timely manner. This may involve the need to invoke wage price controls until the changes in macroeconomic policy take hold. These will depend on the timely introduction of structural reforms especially in the areas of trade, finance and public sector rationalization. Efforts directed towards achieving a social pact should be pursued so that the Government can remove itself from wage-incomes policy deliberations. Timely implementation of structural reforms should facilitate the process. A number of recommendations are summarized in the Action Matrix on the next page. These include, on the institutional side, greater cooperation between public and private sector through clarification of rules of the game, financial sector reform, streamlining of procedures, privatization and public sector reorganization. On the economic side, recommendations include a moderately tight fiscal policy with the deficit being reduced from its 1985 level of 4.2% of GDP. This should be done primarily by reduction of transfers to public enterprises and increases in revenue by reinforcing tax administration combined with a modest increase in receipts from value-added tax. Monetary policy would allow for a slightly positive interest rate for depositors while controlling the money supply and coordinating fiscal policy to help reduce inflation levels. The real effective exchange rate would be allowed to improve gradually through continuation of present mini-devaluations together with trade reform. The basic recommendation is support for present macro policies with continued reliance on fiscal and monetary policies to ensure the downward inflationary path as the critical objective of the Austral Plan supported by an increased reliance in the short-term on increased public sector investment in key areas such as telecommunications and ports. In the medium-term, the private sector would assume an increasingly major role but in the short-term an increased role is warranted for public sector investment initiatives. Even in the transitional period, the proposed investment initiatives are expected to make a favorable impact on the revival of private investment. Industrial sector incentives should be streamlined to reduce some of the obstacles to a more competitive system than has resulted from the present set-up. Overlying all is the need for clear and steady rules of the game to reinforce the gains of the Plan Austral.

PRINCIPAL SPHERES OF ACTION

SUBJECT	ACTION	DISCUSSED IN REPORT (PAGE NO.)
Macro		
- Fiscal Policy	Reinforce stability; aim for a steady reduction of the deficit and quasi-deficit of the public sector over the next two to three year period. Expenditures: reduce net transfers to public enterprises to zero with net return on equity to the Government for some enterprises. Revenues: strengthen tax reform; increase yield from value-added tax, have comprehensive review of all public expenditure/revenues to improve efficiency and the use of economic criteria for investment planning.	10
- Inflation	Continue with policy of not printing money to finance public sector deficit, use external borrowing; aim for an annual rate in 1987 lower than the 80% increase of 1986 and a steady improvement thereafter.	11
- Interest Rates	Seek to achieve real rates that are moderately positive for deposits and as financial reform takes hold aim for average annual real lending rates of around 5 to 10% p.a.	14, 16
- Relative Prices of Tradables	Ensure a competitive exchange rate and tilt to tradables gradually by reducing anti-export bias and continuing mini-devaluations policy.	11
Institutions	Reduce uncertainty through closer public/private cooperation and clarification of rules of the game; streamline procedures/bureaucracy.	5
Growth		
- Short-Term	Carefully chosen increase in public sector investment in areas such as telecommunications/postal system, ports. In order to minimise any inflationary impact, this boost would be financed by higher external net flows, tightening of tax administration and cutting costs in state enterprises, and reducing public expenditure.	5, 16
- General Increase in Private Investment	Reduce uncertainty by clarifying role of Government; create a private investment fund; formation of a privatisation unit; facilitate innovative financing in such areas as output sharing and lease-back project arrangements, and develop improved instruments to increase domestic resource mobilization such as housing fund.	18
Debt	Devise a financing plan matched to a medium term growth pattern; evaluate debt/equity swaps and secondary market opportunities.	22
Sector Policies/ Structural Reforms		
- Financial	Reform of sector with emphasis on strengthening supervision; increasing efficiency, reducing spreads, and rationalising rediscount operations of the Central Bank. This requires studies of both bank and nonbank institutions and the capital market.	6
- Labor	Need to move away from wage controls; rationalisation of public employment in central government, provinces and public enterprises.	13
- Industry	Improve efficiency and competitiveness; reduce time horizon for incentives to 4-6 years; reinforce present efforts by DGI to reduce abuses of incentives.	20
- Trade	Improve export incentive system by eliminating the anti-export bias by reform of the temporary admission system; elimination of indirect tax burden on exports; provide export financing facility at competitive international market rates; devise marketing strategy; reform import system by replacing non-tariff barriers with import tariffs coupled with assistance to firms adversely affected to help them adjust.	23

ARGENTINA

ECONOMIC RECOVERY AND GROWTH

PART I. BACKGROUND

CHAPTER 1. INTRODUCTION

1. Argentina has a rich endowment of human and capital resources. However, the history of its development in recent decades is rife with volatile political, social and economic change. Key macroeconomic aggregates are given in Table 1. There has been a failure to achieve any net growth in GDP since 1978. Even the high growth rates for exports in some years were due to special conditions such as recovery of cereal and vegetable oils exports (1985) from a highly depressed level in the previous year or the success in 1981 when the Soviet Union purchased US$3.5 billion of grain following the U.S. embargo. The result has been a general erosion of Argentina's economic standing vis-a-vis other countries. This is coupled with a widespread feeling of disillusionment inside Argentina with the country's economy and also about Government and its ability to play a constructive role.

2. President Alfonsin assumed the presidency in December 1983. Following the excesses during the military regime, the country was essentially bankrupt with an external debt of close to US$45 billion equivalent to 70% of GDP. Initial attempts at stabilizing the economy failed and finally a new economic team introduced the Plan Austral in June 1985. The Plan was greeted with widespread popular support. It was perceived as saving the economy from the brink of hyperinflation and generally raised expectations for a restoration of economic growth.

3. After a few months of relative success on the inflation front it gradually became clearer that revitalizing the sluggish economy would be more difficult than expected. Indeed the success on the inflation front made more evident the many deep-rooted problems that had festered for the past 20 or 30 years. While the agriculture sector was quite competitive, much of the industrial sector had become accustomed to doing business in a small and heavily protected market. Selected indicators of incentives and external trade are given in Table 2. One notes the instability of the real exchange rate which is a contributing factor to the variability of exports. More recently, shifts in terms of trade exerted a further negative influence on exports. Large swings in real wages and interest rates are indicative of the unstable economic policy climate. Similarly the public sector had not emphasized efficiency during more affluent times and had also absorbed many inefficient enterprises. Since society had adjusted to this way of doing business, there were many socio-political groups who viewed major changes as a threat to their interests. This, in particular, applied to labor markets which were dominated by highly politicized unions, and to various entrepreneurs who enjoyed the rents from their oligopolistic position. Following the introduction of the Plan Austral, the inflationary smokescreen dissipated and it became much more difficult to accommodate such demands. This required that some net gains be available for distribution (a positive sum game) which in turn meant that the economy should be moved without too much delay onto a positive growth track.

4. Argentina has made many attempts at stabilization, and indeed a number of these plans contained elements similar to the Plan Austral. The many changes in Government were not solely due to economic causes. In 1957/58, one finds a one-year wage freeze resulting in fiscal surplus and low inflation rates but failing to produce an increase in real investment. In the early 1960s, low real wages and attractive terms to foreigners produced a surge in investment. However, a poor harvest and high beef prices led to an erosion of confidence in the economy. In the mid-1960s, one finds the other side of the policymaking pendulum with expansionary monetary, fiscal and wage policies. This led to a wage-price spiral, higher public deficit and again a loss of confidence. Following a military takeover, the new economic policy included price and income controls together with an exchange rate devaluation of 25%. While inflation was reduced to 10% and fiscal accounts improved, a fall in grain prices triggered another beef cycle and soon led to a collapse of the program. Following the turbulence of the early 1970s, there was again a period of high wages. This was combined with an inward-looking policy package, control on foreign investment and nationalization of bank deposits. Initially GDP and consumption increased but by 1975 high inflation, increasing fiscal deficits, price distortions and supply shortages were aggravated by a European ban on Argentine meat imports and higher oil import costs. This undermined the economic policy, led to chaos and eventually led to a military takeover. The incoming regime in 1976 moved back to an outward-oriented strategy. The fiscal deficit was initially reduced due to higher real receipts as inflation rates dropped and the introduction of some temporary tax increases. However, as inflation resumed in 1979 a new course was adopted. The peso was devalued vis-a-vis the US dollar at a lower rate than the inflation rate. The overvaluation of the peso led to a surge in imports, deindustrialization, financial insolvency for many enterprises, deterioration in the net external position and fiscal accounts so that finally the program was abandoned in March 1981. However, the large debt accumulated in the period continues to be a major problem for policymakers. Following the South Atlantic War in 1982 and accession of President Alfonsin in late 1983, the economy was faced by increasing inflation, deterioration in the balance of payments and an industrial recession. In late 1984, the Government entered into a 15-month standby agreement with the IMF and in 1985 rescheduled its external debt with commercial and official creditors covering its obligations up to end-1985. In the first half of 1985, economic conditions worsened, Government was unable to adhere to the program and the standby agreement was suspended. The stage was set for the Plan Austral.

CHAPTER 2. PLAN AUSTRAL

5. Plan Austral combined some heterodox measures with more traditional orthodox measures. In order to break inflationary expectations the Government moved from gradualism to shock treatment. Similar plans have also been introduced in Brazil and Israel. A comparison of the initial impact is given in Knight, et al.[1] The key elements were a wage price freeze, tight fiscal and monetary policy and monetary reform. A new currency, the Austral, was introduced with the exchange rate fixed to

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1/ Knight, P.T., McCarthy, F.D., van Wijnbergen, S., Finance and Development, December 1986.

the US dollar. Non-indexed contracts were converted into the new currency according to scales designed to eliminate the capital gains and losses due to the drop in inflation. Table 3 gives some indicators of the results of the Plan. The immediate results were: a fall in inflation from near hyperinflation levels to around 2% per month for the second half of 1985, money demand increased with M_1/GDP growing from less than 4% to over 8%, while the trade surplus for 1985 was US$4.6 billion. The economy began to grow more rapidly in the last quarter of 1985 and the first quarter of 1986. Union groups began to press for wage increases while others expressed skepticism about the ability of the Government to contain the fiscal deficit. Consequently, a second set of measures were introduced in April 1986. This included a move to a crawling peg, some increases in public sector prices, and increases in wages and pensions to help correct their erosion in real terms. The Government also announced its intention to move from the price freeze to a system of administered prices.

Results of the Plan To Date

6. As indicated in para. 4, there have been many failed attempts at stabilization in Argentina. Many reasons can explain their failures but in the final analysis the main reason has been unsustainable pressures from competing groups on resources. The present government seems to have adopted a pragmatic approach and demonstrated a more flexible attitude while not sacrificing the fundamental objectives of the reform. The initial conditions for this plan differed from previous plans largely because of the external debt burden which stood at US$46.9 billion as of end-1984. The transfer needed to service this imposes severe restrictions on policy options. The possibilities of financing investment over the medium-term may be analyzed by considering three aggregate accounts: private, public, and external. As the reform of the public sector takes hold it is expected that expenditures on that account will be compressed. However, in the short term, only limited additional resources can be anticipated from that source. The external account is in surplus to service the debt so that net transfers on that account are of the order of US$2 billion per year out of the country. This in turn means that the burden of financing investment falls on the private sector. The private sector in turn casts an anxious eye on the Government's ability to meet its obligations without either higher taxes or convincing the private sector to absorb domestic debt. They suggest that expenditures be reduced by more prudent management and perhaps some privatization. They argue that this would reduce financing needs, lower interest rates, and then stimulate investment.

7. The annualized inflation rate (CPI) fell from over 1000 in the first half of 1985 to about 40% for the second half. The change in the wholesale price index was even lower. In July 1986 inflation rates began to increase again as the private sector wages increased as the Government sought to relax wage and price controls. In August the increase in the CPI peaked at 8.8%. The authorities constrained monetary growth and strengthened wage and price controls again so that the October increase in the CPI was down to 6.1%.

8. Real wage behavior varied greatly by sector. The main losers were those in central government. Here, real wages fell by 18% over the first 9 months due to continuing erosion by low but positive inflation levels. However, real wage losses in the private sector were largely offset by informal payments.

9. Under a tight monetary policy, real interest rates were initially in the 3 to 4% per month range. While the demand for real balances almost doubled as inflation fell the monetary authorities sought to limit monetary growth. There are those who argue that this may have been unwise but given the recent experience of near hyperinflation it was perhaps correct to err on the restrictive side. In early 1986, as inflation increased and nominal rates were regulated, the real rates dropped close to zero and even negative for a while prompting some disquiet over the possible resumption of capital flight.

10. The Government sought to restrain fiscal policy by pledging not to issue money to finance the public deficit but to finance any deficit by external borrowing. The substantial improvement in the fiscal accounts was achieved almost completely on the revenue side. Revenue increased by the equivalent of 6% of GDP between the first and second half of 1985 due to higher real receipts as inflation fell together with improved tax administration. There was some slippage on the expenditure side due to losses by the Central Bank on their rediscounts, and higher-than-expected expenditures by provincial governments. These were partially offset by lower transfers to public enterprises.

11. The initial level of the real exchange rate depreciated as inflation resumed even though at a much lower rate. The nominal exchange rate was pegged to the US dollar and benefitted from the depreciation of that currency by about 40% vis-a-vis that of other industrialized countries during the first eight months of the program. This meant that the real exchange rate for the Austral varied little until the second quarter of 1986. A strong trade surplus of US$4.6 billion resulted in 1985 largely by severely curtailing imports, but owing to interest payments of close to US$5 billion the current account deficit was about US$1 billion.

12. After nearly two years the verdict on the Plan is perhaps one of qualified success. However, increases in inflation of the type experienced in August 1986 and again in January 1987, emphasize the need to expedite the structural reforms. Strong measures have been taken to improve the institutions of tax administration and reform of the public enterprises by seeking to improve management. Following a sluggish first half in 1986, real growth picked up strongly in the second half for a yearly increase of 5.5% for GDP. Investment was up 11.9% including a turnaround in private investment. The performance on the inflation front and in cutting the overall public sector deficit is commendable. In July/August 1986 inflation again increased and the administration initially responded (August 1986) by curbing money growth and again strengthening price controls. At the same time measures were initiated to give banks the authority to carry out transactions previously handled in the black market. This constituted a <u>de facto</u> lowering of reserve requirements and was a step towards making them more competitive. Alarms were triggered when the CPI for January 1987 reached 7.6%. A new set of measures were introduced in February 1987 with the stated purpose of curbing inflation and reactivating the economy. These included a 6.6% devaluation of the Austral followed by further devaluation of 2% in May and again in June, an increase in the minimum wage of 13% together with inflation adjustment for the first quarter followed by a freeze until June, a price freeze (<u>sine die</u> to avoid speculative behavior), increase in public utility charges of 2%, petrol 15%, cigarettes 15%, and a move to cut regulated interest rates to 3% (deposits) and 4% (lending). Proposed measures include a monthly budget for rediscounts and also to introduce a futures market in public bonds. The wage/price measures should be seen as temporary to provide some time to

progress with the structural reforms especially in trade, finance, and public sector. There is also the possibility that major parties may avail of the opportunity to move toward a social pact and introduce institutional reform to permit the withdrawal of Government from wage incomes bargaining processes.

PART II. POLICIES FOR GROWTH

13. The Argentine Government perceives the main objective of economic policy as being to provide a sustainable steady growth to help consolidate democracy. In the Argentine context as in most others, various facets of adjustment such as financial sector and public sector reforms can best be facilitated during a period of strong economic growth. This requires a consistent set of policies in the monetary, fiscal and pricing areas together with concomitant changes in behavior and institutional reforms. Inevitably these areas are interconnected but for exposition the report is focused on three broad areas: institutions, domestic, and external balance in Chapters 3, 4, and 5, respectively. Many of the measures have already been set in motion and, if the underlying policy reform agenda is carried through, could be expected to lead to a buoyant medium-term scenario. However, the short-term or transition phase poses special problems as political expediency may require more dramatic measures. This is discussed in Chapter 6 together with medium-term policies and prospects.

CHAPTER 3. INSTITUTIONAL REFORM

14. If the economy is to move forward to realize its potential, then it should seek to have a more flexible price policy, be less bureaucratic, and more open both in terms of outward orientation of the economy and receptivity to fresh ideas and changes. Institutional change is needed to facilitate this transition. Four aspects are noted: uncertainty/rules of the game, financial sector reform, procedures/bureaucracy, and the Brazil/Argentina Trade Pact.

Uncertainty/Rules of the Game

15. In recent years, erratic economic performance of Argentina has introduced a strong element of uncertainty. The macroeconomic policy environment has been quite unstable up to the Plan Austral. In spite of the relatively stable environment since then, entrepreneurs tend to be risk-adverse in their decisions for their sphere of activity and on investment, in particular. This is a serious and profound problem. It requires a major commitment by major groups in public and private sectors to reach a viable consensus on their respective roles. This could be facilitated by formation of various informal groups on such areas as industrial strategy, export promotion, regional development with broad based participation. It would work towards a clear articulation of the rules of the game. While present complaints about the absence of such rules may be a rationalization for continued rent-seeking behavior, there is a legitimate need for clarification. However, it must be noted that a number of issues need political resolution.

<u>Recommendation</u>. Presently the public is kept informed on short-term policy measures but there is not sufficient information on medium-term goals. The Government paper on Industrial Strategy did provide some outline on policy but at a general level. There is a need for a statement at the highest

level of Government to clarify what the policy framework is for the short- and medium-term and what type of economic structure can be expected, ideally over the next 5 to 10 years but at least for the term of the present administration. It is essential that the statement be credible - this could be facilitated by involving key groups in developing the positions. This could include: broad fiscal objectives, what will and will not be the role of the Central Government, provincial governments and public enterprises; what the overall objective is of fiscal policy; financial sector policy; on exchange rate, whether it is the intention to tilt gradually towards the traded sectors; trade policy, which industries can be expected to face stiffer competition and when; which sectors can or cannot expect to benefit from incentives; privatization; outline the priorities of public investment program; when can an improvement in social services be expected; when can the provincial governments expect to have their rediscount facilities phased out.

Financial Sector Reform

16. The financial system affects virtually every area of economic activity. A detailed analysis is needed. Currently the system is fragile, inefficient, very high cost, fragmented and to a large measure does not fulfill its role as financial intermediary as it has discretionary control only over about 28% of its assets.

Recommendation. There is a need for financial sector reform to address three major areas: fragility/confidence, inefficiency, management (in particular, of rediscounts).

(a) Fragility/Confidence

17. There are serious problems with some banks where much of their assets are immobile and the poor quality of their portfolios is questionable at best. A more active supervisory ability of the Central Bank is needed particularly for loan classification, on-site inspection and improved public disclosure of financial information on individual banks. This would seek to facilitate a smooth transition to a more secure system and at the same time be endowed with adequate legal authority to eliminate any undesirable practices. The public confidence in the banking system could be improved by an insurance scheme for both public and private banks.

(b) Inefficiency

18. During the period of high inflation before the Plan Austral the level of real balances had shrunk and the velocity of money increased (in May 1985 the monthly velocity was about 2.0) as people moved out of pesos and sought refuge in a plethora of financial instruments. To accommodate these needs, banks, their branches and employment increased dramatically. As inflation falls, the demand for these services subsides so that banks now find it increasingly difficult to maintain operating costs. The spread (above average cost of funds) needed for operating costs (net of commission) is presently estimated at 1.64% per month or 23% per year. Spreads to provide the Argentine economy with competitive financial services should be in the range of 5 to 10% real per year typical of other countries. A comprehensive reform package will need to provide help to banks to facilitate mergers, reduce staffing and at the same time reorganize the liquidation procedures of banks.

(c) Rediscounts

19. Over 60% of the credit to the private sector is channelled through a complex system of rediscounts. These rediscounts are financed by substantial reserve requirements (see Table 4) and then channelled through the Central Bank to a variety of intermediary and end-users. Virtually every rediscount is a special case with its own set of terms and a potential for abuse. While some rediscounts serve a useful function that possibly would not be satisfied by normal market channels, there are a number of serious problems.

(a) Because of losses incurred by the Central Bank there is a fiscal cost known as the quasi-fiscal deficit.

(b) It leads to a highly fragmented market.

(c) Because of the reserve and forced savings requirements, the banking sector has no discretion over 72% of total deposits.

20. Over time many of the problems could be largely eliminated by an orderly contraction and reduction of these rediscounts. This would require a much improved management information system. The required reserve levels could be reduced to around 20% of deposits. This could be achieved through an orderly transition to preclude any disequilibria in positions of financial intermediaries and satisfy legal requirements of contractual arrangements. At the same time the reform package would provide a safety net to facilitate the changes that would result as provincial governments no longer had ready access to this source of financing.

Procedures/Bureaucracy

21. A complex plethora of public institutions has evolved so that issues of access to government funds or import permits and exemptions from various taxes are major considerations (and time consumers) for many entrepreneurs. In many aspects of public administration, inefficiencies abound. Taken one at a time, there are similar examples in most other countries. However, in few countries as advanced as Argentina, is there such an agglomeration. A typical example is given in Table 5 of just one aspect of the complex fiscal system. The present system is quite cumbersome. Equivalent tax revenue could be generated with a rationalized system. Each inefficiency is likely to be associated with some form of rent-seeking activity and in a stagnant economy, the recipients of these rents are unwilling to give them up very easily. If the country does succeed in moving to a higher growth level, it might be easier to achieve improvement in efficiency.

22. As the economy seeks to become more open these inefficiencies will severely hamper its competitiveness.

Recommendation. (a) For all procedures and bureaucracy that directly affect the external sector, an independent authority should be appointed to propose an alternative comparable to best practice in the more efficient economies with which Argentina competes. (b) On the domestic side, an independent authority is also needed to mobilize public opinion to identify abuses as was done with some success to reinforce the price freeze during the early days of Plan Austral with only minimal bureaucracy.

Brazil/Argentina Trade Pact

23. On July 29, 1986, a set of 12 protocols were agreed on by the Presidents of Argentina and Brazil as a basis for a future common market for Latin America. They are focused primarily on capital goods where it is anticipated that all tariff and non-tariff barriers to bilateral trade between Argentina and Brazil will be eliminated. The implication of this bilateral trade agreement needs to be analyzed carefully. One immediate result expected was that Argentine wheat exports would benefit. Presently the producer price for wheat in Brazil is over US$240 per ton while Argentina exports at about US$75 per ton. The capital goods sector in Brazil now has a delivery time of 12 months for orders due to the booming economy. Also financing is not available for foreign suppliers. This should give an immediate opportunity to Argentine producers. While there are obvious trade opportunities generated, perhaps even more important would be the implied erosion of isolationist thinking. Politically there has been virtually unanimous support. The extension of the temporary admission scheme (early 1987) to include all Brazilian imports to be used for exports offers the possibility for reducing domestic costs in industries such as food processing. The accords are expected to result in an increase in exports of capital goods from US$50 million to US$100 million in 1987 while most recent estimates are for annual wheat exports of 1.5 million tons. Prospective large market opportunities in a neighboring country are attractive especially when world market prospects seem difficult over the medium term.

CHAPTER 4. MACROECONOMIC POLICY

24. The main concern of economic policy is to consolidate stability while moving to sustainable growth. This requires a careful blending of an acceptable fiscal deficit including adequate resources for investment so that the level of financing needs will not jeopardize stabilization. We first consider the resource situation.

Resource Availability

25. Some indication of the magnitude of resource flows involved is given in Table 6. For selected years, the savings-investment balance is estimated for the private, public and external sectors. The role of the debt is highlighted by also including interest payments. Major shifts in the balances occurred from the early and mid-70s to recent years. During the early years, the low external debt interest payments around 1% of GDP allowed the external sector savings (Trade Balance) to also remain at low levels. During these years, investment was in the 22 to 24% of GDP range with the public sector accounting for about one-third of the investment. The financing pattern was typically that the public sector current account (excluding interest payments) was close to balance or even in surplus some years so that it could make a positive contribution to aggregate savings while the private sector financed the rest.

26. In 1980 and 1981 large adverse current account balances (see Table 1) made the achievement of external equilibrium increasingly elusive. The authorities sought to finance investment by increased external borrowing but at the same time savings were channeled abroad. The external transfer needed to service the debt reached 7% of GDP. The private sector, faced by the prospect of widespread bankruptcies, was unable to meet the external obligations so that the public sector stepped in to assume much of these debts. While this provided some respite for the private sector the impact on public sector finances was disastrous. Much of the adjustment by both public and private sectors was borne by investment. Thus the share of public sector fixed investment (National Accounts definition) fell steadily to reach an all time low of 3.8% of GDP in 1985 while the total gross figure fell to 10.6%. Average per capita income fell in these last years but there was an even steeper decline in savings rate and especially the private savings rate which dropped to 14.3% of GDP in 1985 from previous levels close to 20% of GDP. It also seems that some reduction in savings effort by the private sector was associated with the Government assumption of much of their debt in 1983/84. Where can increased resources come from? There are three complementary lines for dealing with the problem:

(a) increased savings by the public sector;

(b) smaller trade surplus by increasing imports with corresponding external capital inflows; and

(c) increased savings by the private sector.

27. The first line would require either increased public sector revenues or expenditure reductions. It is desirable to have a thorough public expenditure review soon. This would emphasize improved efficiency of expenditure and greater emphasis on the use of economic criteria in formulating investment policy. On the revenue side current initiatives on tax reform and the tightening of tax administration have already produced substantial gains but further increases above 27% to 28% of GDP are likely to prove more difficult. On the expenditure side a number of initiatives in public enterprises can be expected to yield results over the medium-term. Active implementation of the reform on the rediscounts should be a high priority. The remaining major item, capital expenditures, has already been cut, perhaps even too much. While improvement may be expected over the medium-term it seems unlikely that the public sector deficit of about 4% in 1986 can be further reduced by much more than 1% per year. Continued pressure is needed to ensure steady progress. The deficit of the non-financial public sector for 1986 at 2% of GDP showed an improvement of 6% of GDP over the corresponding period in 1984.

28. The second option is to some extent outside the immediate direct control of Argentine policymakers but will be conditioned by how that country and its economic policy is perceived by the outside world and how negotiations on external debt evolve. This in turn will determine what additional net capital flows and under what terms may be forthcoming. Recently Congress approved legislation that includes an amnesty or "blanqueo" which is expected to lead to some repatriation of capital flight. However, any significant reversal of capital flight seems to be contingent on a stable economic regime with adequate profit opportunities.

29. The third option is conditioned by the perception of Argentines of their own economic regime. To date the private sector's investment response has not returned to levels of the 1970s. The reasons offered for this reluctance are lack of clarity in the rules of the game (discussed in para. 15) and the feeling that the Government has not yet come to grips with the "hard" structural issues, i.e., it would like to see the fiscal deficit reduced even further and a diminished role of the public sector especially in the productive sector. The worldwide decline in oil prices and comparably dim prospects for wheat and beef also discourage private investment. For the present the private sector remains on the sidelines. Private sector response in a sustained manner requires a steady increase in confidence in economic policy together with the availability of adequate financing at reasonable terms. Some specific measures to address this are given later in this section. In particular domestic resource mobilization could be increased through a well-designed housing finance program. One such program, the UPAC system has proven quite successful in Colombia.

30. From the resources perspective, it is essential that the private sector make a stronger contribution than its present savings level of under 10% of GDP and return to its more traditional savings levels of 19 to 20% of GDP. It seems unlikely that this will occur in the next year or so. However, it is necessary to analyze the factors which are retarding savings and seek to introduce appropriate vehicles to improve the situation. Thus in the short term, it becomes necessary to rely to a greater degree on option 2, increased imports financed by additional net external flows. We now move to consider the budget implications.

Fiscal Balance

31. Public sector finances are summarized in Table 7. These are discussed further in Chapter 6. On the expenditure side wage and salaries constitute about 9% of GDP. It is unlikely that this can be cut much further for the Central Government. Transfer payments also constitute about 9 to 10% of GDP. The net transfers to public enterprises should be reduced to zero from their 1985 level of 1.79% of GDP. In fact there is no reason why at least some enterprises should not make a positive contribution to public finance. Because of restructuring costs it does not seem realistic to expect this to be completely achieved in less than two to three years. The large subventions to enterprises such as Argentine Railways are hard to trim in absolute terms while pension payments will increase with population growth (Argentina has a high dependency ratio of close to 2:1). However, as a share of GDP these can be reduced in a more buoyant economy. The interest payments (while only including national and provincial governments) will be largely determined by international interest rates on the external side while domestic real rates should not be allowed to become negative. The question then is what is the nature of the trade-off between the deficit, its financing and inflation.

32. Analysis shows that there is a strong relation between the budget deficit and inflation. If one could in fact reduce the deficit to zero there is general agreement that this would have a highly favorable impact on inflation, inflationary expectations and overall confidence in the policy regime. The problem is how to do this and over what time frame. The non-interest public sector deficit together with interest obligations on domestic and foreign debt can be financed by a combination of four

principal avenues. These are increases in foreign debt, increases in domestic debt, seignorage gain and finally the inflation tax. Increases in foreign debt are subject to agreement with foreign lenders while domestic debt cannot be prudently increased much above its present level of about 25% of GDP. Seignorage gain comes from increased growth rate for a given level of monetization of the economy. The remaining "source" of financing is the inflation tax. The amount of this tax results from the interaction of two effects. Higher inflation tends to increase the tax but at the same time increase in inflation also reduces the monetary base. Thus there is no unique answer to what each source of financing should contribute to various deficit levels. A range of possible consistent choices for two deficit levels 3.6% and 2% of GDP are presented in Table 8.2/ In this table the role of domestic debt is essentially neutral. This means that new domestic debt can be issued to cover the costs of existing debt. If there were any significant increase in domestic debt above present levels this would exert further inflationary pressure. Other combinations can be developed as needed for alternate variable choices but the key feature is that for given availability of net external flows the level of the deficit is determined by the equilibrating inflation level.

33. One could also seek to accelerate the reduction of the budget deficit through restrictive fiscal policy. This, in principle, could include temporary consumption taxes, higher income taxes and some inframarginal capital taxes. This package would lead to a reduced consumption but higher investment levels which is very unlikely to be politically acceptable. A different approach, high case scenario, is discussed in Chapter 6. This is close to the second scenario in Table 8 (II). It aims to reduce inflation to zero and leads to a reduction in real debt in the medium-term.3/ The key to this scenario is that additional external resources should be made available in the short-term to finance higher growth through well-targeted investment expenditure. Through real economic growth the deficit is reduced as some expenditure items (transfer and interest payments) do not expand as rapidly as a share of GDP. This also requires some new revenue measures (higher VAT receipts) be phased in gradually.

Recommendation. Improve efficiency of all public expenditures so that over the medium term the fiscal deficit will be steadily reduced. Specific measures could be identified through an early comprehensive review of all public expenditure revenues. In the short-term, use additional external financing or improved domestic resource mobilization to increase well-targeted investment expenditure. This point is expanded in Chapter 6.

Relative Price of Tradables

34. During recent years the policy on exchange rate has been quite erratic. The real exchange rate since 1970 (See Table 9) indicates substantial variations in the quarterly index. There are a number of

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2/ The deficit for 1986 was 3.6% of GDP.

3/ Inflation in 1986 was 80% (CPI).

technical problems in constructing such an index where one has large intra period variations and substantial changes in financial/commercial spreads. There is also the issue of choosing the appropriate base year. In the late 60s to early 1970, most analysts would agree that the rate was at a "reasonable" level as Argentina enjoyed strong trade surpluses. Similarly there is consensus that it became grossly overvalued during the Martinez de Hoz stabilization period. This was followed by the contractionary policy and the modest rise of the real exchange rate following the Plan Austral. The pegging to the U.S. dollar turned out to have been a rather fortunate move as the real exchange rate vis-a-vis its aggregate trading partners showed little deterioration for most of the first eight or nine months of the Plan. However, it could not have been maintained without a continuing fall in the US dollar.

35. In April 1986 the Government adopted a policy of mini-devaluations to achieve a competitive exchange rate. Since then, there have been a number of mini devaluations. The parallel market premium provides a useful barometer of both confidence and whether the official exchange rate is getting out of line. Because Argentina has a relatively open capital market this indicator can also be quite volatile. Measures to reduce this volatility such as the recently (February 1987) proposed futures market in Government bonds are desirable. In view of present adverse movements in terms of trade it is important that the real exchange rate should not be allowed to deteriorate further. The issue is discussed further in Chapter 5 in the context of external equilibrium.

Prices/Wages

36. The incomes policy is one of the key features of the Plan Austral. Under the Plan, a price freeze in June 1985 was modified to a more relaxed price control (administered) system in April 1986, but then following a resurgence of inflation in July/August of that year, price controls were again strengthened on August 29, 1986. These volatile inflationary excursions highlight the need to seek a more market-oriented system as soon as feasible. Prices in Argentina may be loosely classified into three categories: public services, mark-up pricing and market pricing. For most public services, prices should seek to recover costs while relatively competitive sectors have the discipline of market pricing. The biggest problem seems to arise in those industrial sectors where producers enjoy some degree of monopoly or oligopoly power in a protected market. These sectors are identified more clearly later in this section in the discussion of industrial sector issues. When faced by strong union demands these producers historically accede and simply pass on costs to consumers. This had led to sharp fluctuations in nominal wages but ironically the trend in the average real wage has been close to zero over the last two decades. For all practical purposes, there has been no growth in the average earnings of wage earners in Argentina since 1950. Economic growth has resulted in extra employment, and, perhaps, real increases in the incomes of the self-employed (about 30% of total employment in 1980). Some degree of import liberalization can help to restrain inappropriate price increases. A major problem is the absence (on average) of any significant productivity gains over the last few decades. Because of the absence of such gains, distribution conflicts tend to be heightened. While a "workable" wage policy or social pact is urgently needed, a positive sum game would allow such a pact to work. The

absence of a stable economic environment and a relatively closed economy has resulted in a bias toward financial transactions with an indifferent record on productivity. A detailed study of industry should be able to identify actions needed to increase productivity since Argentina's record in this respect ranks poorly by international standards.

37. In spite of the crucial importance of wages, it is quite difficult to obtain agreement on an appropriate index of the real wage. The INDEC series shown in Table 3 shows a steady erosion of the real wage (official blue collar) under the Plan Austral up to February 1986 as nominal wages were held fixed and inflation continued at around 2% per month. However, this index may not be a comprehensive measure of the complete wage situation. The Government's nominal wages per hour for each category (grade) were held in check up to early 1986 at which time they had lost close to 20% in real terms. However, if one examines total Government wage payments per employee in the fiscal accounts, there is some drop but not nearly so precipitous. This is accounted for by two phenomena: increase of overtime payments and grade creep. In the private sector there is some evidence of various side payments such as low interest loans. Many of these informal payments are being regularized presently. The result has been that in the private sector the adjusted real wage has not fallen and may indeed have risen in some subsectors. The main losers on the wage side appear to have been government workers and those on pensions. The problems for policy posed by the three categories of public employment are very different. Almost a million people are employed in Administracion Nacional and Public Enterprises, distributed among 250 agencies and with about 150 "escalafones" (payroll systems). In Administracion Nacional, the reduction in real salaries has caused a shift in employment towards secondary earners (females and youth) to the detriment of a civil service career. Public Enterprises continue to be a large fiscal burden so that the reduction in employment in the last 10 years is probably not enough for efficient operation. The expansion of employment in local government is, very likely, the outcome of political pressures and the ability of provincial governments to finance their operations through provincial banks. Unification of "escalafones" and creation of a civil service, further economy of operation in public enterprises, and control of employment in local government are important policy objectives.

38. Following the initial setbacks of the tripartite conference between Government, private sector and unions to reach a social contract, wage policy again became the responsibility of the Government. In a mixed economy such as Argentina this is obviously an undesirable situation. It is desirable to move away as soon as is expedient from wage price controls without reverting to wage indexation which tends to accelerate inflation and introduce downward rigidity in average real wages. A social pact could help the Government set the stage for their own withdrawal so that over time wage income discussions would be between representatives of workers and management. The removal of price controls presents a number of problems. For competitive subsectors this can be done in harmony with the trade reform. For subsectors that need to adjust to external competition prices can be negotiated as part of a broader package (including trade liberalization, pricing of inputs by parastatals, restructuring programs). For some subsectors the danger of domestic producers exerting oligopolistic control needs continued attention.

Interest Rates

39. Selected interest rates are given in Table 2. When the economy went from the near hyperinflation levels in May/June 1985 to the relatively low monthly levels of approximately 2% in the months soon after the Plan Austral (see Table 3), the real interest rate increased. This phenomenon has been observed during other stabilizations in similar high inflation situations including the German experience of the 1920s. There are a number of explanations available. One is that demand for real balances (money deflated by the price index) is a function of nominal interest rate. During high inflation nominal interest is also high. The introduction of stabilization means that the real money stock remains more or less constant initially. This, in turn, means that the nominal interest level, to equilibrate the system, needs to fall little if any. Accordingly, under the new much-reduced inflation levels the real interest rate rises sharply. Ideally one would like to reduce this real interest rate as quickly as feasible. This, however, requires a judicious adjustment of the rate of monetary expansion to changes in velocity and the inflation level. During the year after the introduction of the Plan Austral, the demand for real balances has more than doubled from pre-Plan levels. The Government policy has concenrated on short-term fine tuning. At the at the beginning of the month M4 4/ is adjusted to try and maintain liquidity on an even keel by seeking to avoid major erratic fluctuations in market interest rates. This is quite difficult as excess money supply can trigger a resurgence of inflation while undue tightness drives up real interest rates too high. The historical experience suggests the best course is that immediately after stabilization one must keep a tight rein on money supply and then as confidence is restored and velocity falls one can increase the supply in a prudent manner. This would ideally result in a dynamic adjustment path that in the first stage would lead towards convergence of inflation, interest and exchange rate changes. This essentially seems consistent with the policy followed by the Argentine monetary authorities as indicated in Graph 1.

40. In the second stage, it is important for the level of inflation to move closer to zero. This has proven more difficult. Consequently, the interest rates are higher than might be desirable for investors in fixed assets. However, this poses a dilemma for policymakers. If interest rates are allowed to become negative in real terms, as seemed imminent in May 1986, there is always the threat that holders of financial assets may place them abroad. In Argentina this is always a consideration where capital flight during the previous regime has resulted in Argentines holding assets in excess of an estimated US$30 billion 5/ abroad.

41. Perhaps the most significant factor in pushing up interest rates are the Government's own financing needs. If the financial sector reform proceeds along the lines indicated, this should help to reduce interest rates over time. In the meantime it seems appropriate at the lower limit

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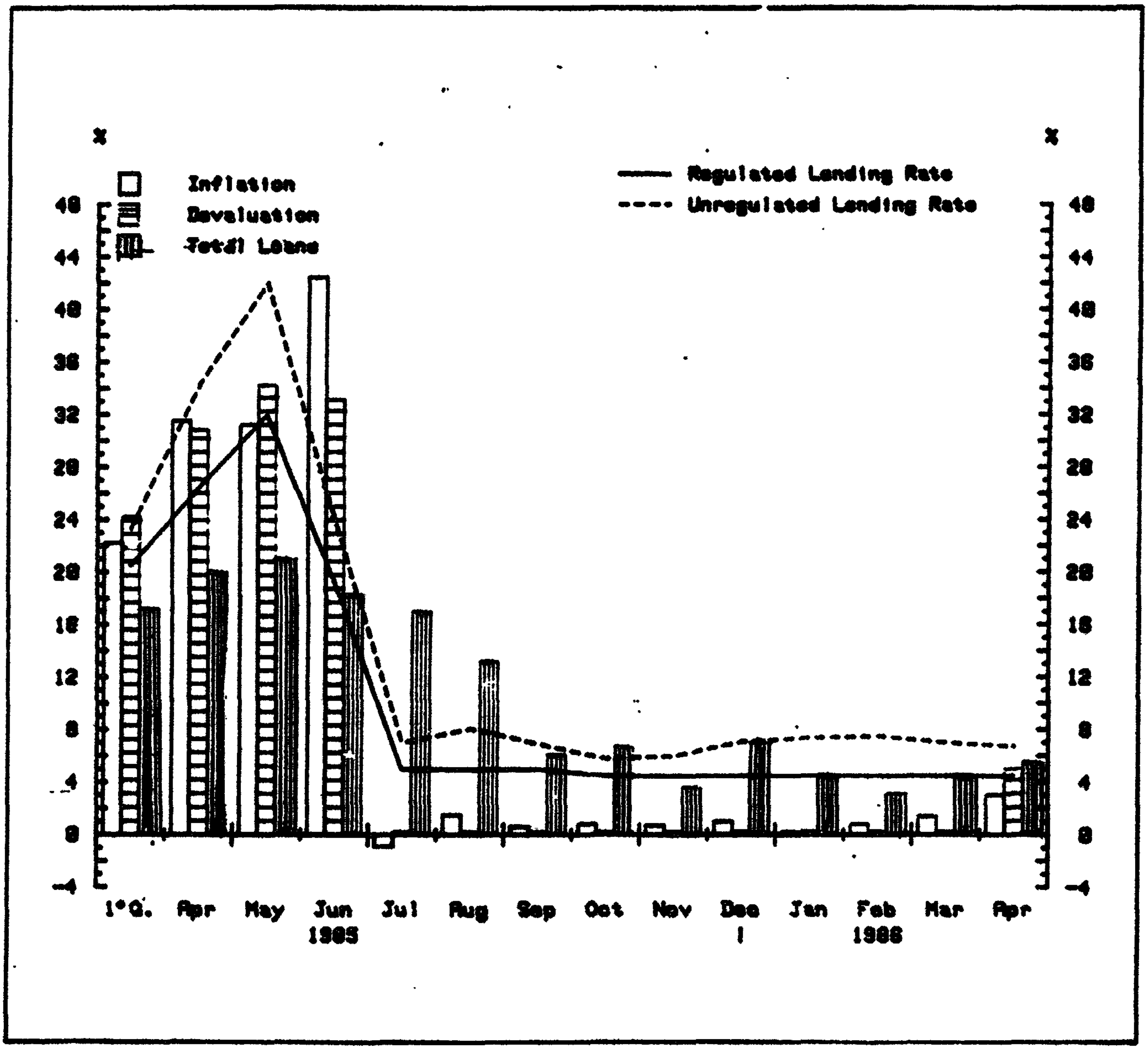
4/ M_1 = Currency + demand deposits
M_2 = M_1 + regulated time and savings deposits
M_3 = M_2 + free deposits
M_4 = M_3 + indexed deposits

5/ See World Financial Markets, Morgan Guaranty, March 1986, for a review.

<u>Graph 1.</u>: KEY ECONOMIC INDICATORS
(% MONTHLY EFFECTIVE RATE)



Source: G.F. Macroeconomia.

to keep a floor of zero or moderately positive real interest rate for depositors as lower rates would only encourage capital flight. The upper limit should also be contained to avoid higher rates that push up costs for investors. There is evidence that high real interests do not stimulate overall savings but encourage a shift away from real investment in favor of financial assets. Thus, over time the aim should be to achieve average annual real lending rates of around 5 to 10%.

Investment

42. Resumption of growth requires a significant increase in investment from its present depressed level of 11.9% of GDP (1986) to more traditional levels of around 22% of GDP as indicated below. A Dennison style accounting suggests that a steady state growth rate of 4% could be achieved consistent with these levels of capital accumulation. Estimated factor contributions to GDP, annual growth rate, are 0.7% and 1.8% for labor and capital, respectively for the medium-term. This would require a contribution of close to 1.5% for technical change/productivity. On the basis of comparative country studies and more stable historic years in Argentina this seems reasonable. In the mixed economy that has evolved in Argentina, public and private investment have been closely related so that in most sectors private initiatives have tended to follow or accompany those of the public sector.6/ While restoration of the private sector contribution to resource mobilization is central to medium-term growth, in the short-term the public sector will still be obliged to play a critical role. Constraints on the deficit pose a difficult problem as financing needs and the inflation trade-off need careful consideration.

INVESTMENT - PUBLIC/PRIVATE /a
(as percentage of GDP)

	1970	1977	1982	1983	1984	1985	1986 est.
Public	8.5	11.1	6.7	6.4	3.9	3.8	4.5
Private /b	13.7	13.2	9.9	7.8	8.5	6.8	7.4

/a BCRA (national account) definition.
/b Including inventory.

Public Investment

43. A recent review of the public investment program7/ undertook detailed analysis of the following sectors: energy, transport, industry and urban infrastructure. In many instances public investment is urgently

6/ An econometric analysis gave a correlation coefficient of 0.64.

7/ Argentina Public Sector Investment Review. June 1986. The World Bank, Report No. 6354-AR.

needed but only energy and transport have a coordinated plan at this stage. In deciding on public investment expenditures, a number of desirable properties would include:

(a) contribute to medium-term productive capacity and infrastructure of the nation. They should not include poorly conceived make-work projects;

(b) have a favorable impact in the short-term on supply responses by relaxing key bottlenecks;

(c) have an acceptable impact on finances of the public sector and ideally generate a positive cash flow promptly;

(d) clarification of what are and what are not appropriate spheres of activity for Government; and

(e) have, wherever possible, a specific complementary role for the private sector.

44. At first glance, it would seem there are few measures which could fulfill all of these but there are a number which might be worthy of consideration. The order in which these are presented should not be construed as indicative of their relative importance.

(a) <u>Telecommunications and Postal System</u>. The present state of these services is a major constraint on the efficiency of business operations. A more dependable telephone/postal system is essential to any modern country. Current efforts in this area should be strengthened to move quickly to reliable profitable operation.

(b) <u>Ports</u>. The port of Buenos Aires is one of the most costly in the world. Wage costs alone do not account for this. If Argentina is to improve export performance it is essential to be able to move the goods more cheaply and efficiently. Presently Argentine wheat producers share about 50% of the world price compared with 75% for their U.S. counterparts. This is primarily because of the high transportation and distribution costs. Most modern exporting countries have roll-on, roll-off facilities for containers and facilities for handling bulk carriers together with matching road and rail networks. This could attract private participation. This would be part of an integrated transportation plan.

(c) <u>Social Services</u>. Water supply and sewerage are so undercapitalized that the risk and concomitant costs of disease justify improvement. Other areas where the public may be willing to pay could include health care and education, although there are problems in moving quickly in this area. Historically much of the poverty in Argentina has been in the provinces. This requires that regional considerations should be weighed in deciding investment initiatives.[8]

8/ A forthcoming World Bank report will analyze public social services.

(d) In addition there is a great need for expenditures on maintenance and goods and services in transportation and infrastructure, while the energy sector could benefit from greater emphasis on transmission and distribution as opposed to generation, particularly to reduce the high level of losses in the system. This could be complemented by hydrocarbon investments.

45. Financing of public investment and especially increased public investment poses a major issue. Some orders of magnitude are given in the final section but it is essential that any increase in public investment be financed without any additional inflationary impact. This would require additional external financing, reduction of tax evasion, and cuts in some other public expenditures. Some potential items within the latter category are discussed in Chapter 6.

Recommendation. It is recommended that maintenance and needed complementary input expenditures not be allowed to decline. In fact, they should be increased. In addition, a coherent incremental investment program and a list of projects should be prepared incorporating the criteria suggested and the domestic private sector and foreign lenders or investors be invited to participate. The preparation should indicate financing needs, cash flow, employment and fiscal impact.

Private Investment

46. Historically, private investment levels have been 50% higher than public. It is important to increase the private sector's participation in the economy. The review of the public expenditure should also consider how best to get both sides cooperating together and to identify projects which the private sector could undertake. In the last few years, private investment has been little more than sufficient to offset depreciation. The reasons given by private entrepreneurs are:

(a) Unclear rules of the game (discussed in Chapter 3), uncertainty about macro policy and in particular what they (private sector) perceive as lack of decisive action by the Government on what they feel is a bloated public sector. As political and economic stability is reinforced some of these reservations due to uncertainty should be lifted. However, in the meantime, some action may be taken by the public sector to help reactivate the private sector.

(b) Lack of readily available funds at an acceptable rate. Currently investment credit lines from BANADE are the only viable medium-term financing source available to firms for expanding, modernizing and updating their operations. Costs of working capital are around 25% per year in real terms thereby imposing a further constraint on expansion of economic activity. Financial sector reform should, in time, lead to reduced spreads. In the meantime, alternative approaches are needed.

Recommendation. Use existing private banks to create a window for the availability of foreign exchange for financing investment. Funds could be channelled through the Central Bank to a consortium of private banks. This would be coupled with some level of matching funds from the consortium and would include appropriate safeguards. This would help finance medium- and long-term investment activities in the country and introduce some competition to provide the best service to clients. At the same time some free-standing funds should be made available for working capital.

(c) <u>Privatization</u>. It is essential to improve the role of the private sector in the economy. The private sector has indicated that much of their concern about the public sector would be allayed by successful privatization. This would lead to reduction in subsidies to some state enterprises but there are also restructuring costs involved so that it is not clear what the economic gain to the Government would be. It could provide a boost to the seeming lack of initiative of the private sector. In economic terms potential candidates for privatization must be assessed in terms of: (a) the impact on efficiency; (b) adding resources, at least in the medium- to long-run; and (c) income distribution. Privatizing enterprises that would retain a monopolistic position are less likely to increase efficiency. In the short term, privatization could result in crowding out of private sector depending on whether the financing comes from domestic resources or not. Thus, a pragmatic approach is needed. Initially the public sector minority holding in some companies could be divested. At the same time, the possibility of "deregulation" permitting the private sector to assume certain public service seems desirable. Besides such mundane areas as street cleaning (where there is some experience) one could envisage leasing railway lines to the private sector.

Fortunately there is now substantial experience available from other countries. For Argentina, the Italian experience with the IRI conglomerate merits consideration. For that conglomerate a deficit of US$2 billion in the early 1980s was reduced to close to zero last year; perhaps even more important was the process of implementation in a country with complex political and union relationships. Some units were sold but substantial efficiency gains were obtained in a number of public enterprises by achieving economic reforms with a judicious balance of political interests.

<u>Recommendation</u>. The Government should coordinate its privatization efforts, evaluate all relevant criteria, decide what should be privatized and how, and formulate a policy and strategy. This could be facilitated by reviewing the experience to date in other countries. In the meantime, the public sector's minority position in selected companies would be possible candidates for divestiture. This could be complemented with "deregulation".

(d) <u>Attracting foreign portfolio investment through the creation of a country fund for Argentina</u>. The country funds have advantages for channeling foreign portfolio investment through the purchase of equity securities in the local market. Recently various country funds have been established for this purpose. The most notable case, the Korea Fund, has appreciated in market value by over 150% since its initial public offering in 1984, and in 1986 has issued additional shares. However, the Mexico Fund was not very successful initially.

Recommendation. Government should identify an appropriate agent to test the market for a fund placement.

(e) Innovative financing techniques for project finance (foreign and domestic) could be explored as potential sources of financing. With Government sharing risks, debt financing could be raised so that creditors rely on the cash flow of the project and a security interest in the assets of the project as their source of repayment. As evidenced by the financing engineered for the Centro-Oeste gas pipeline, variations of the Project Finance technique have already been experimented with in Argentina. At this juncture it would seem desirable to minimize the financial contribution of the public sector to these initiatives.

Recommendation. Appoint an authority to identify sources and types of guarantees needed. These could be production-sharing approaches or lease-back arrangements. The latter could minimize the impact on the public sector capital account.

(f) Direct Foreign Investment. Market signals are a key ingredient for attempting to attract new funds to Argentina. Publicly available information on Argentina is limited and that which exists does not convey the most positive investment climate. Multinationals leaving Argentina contribute to this image - especially when they include units of General Motors, Chrysler Corporation, Eli Lilly & Co. and International Telephone and Telegraph. However, since the return of democratic government and, in particular, since the introduction of the Plan Austral this process has been arrested.

Recommendation. Government needs to review foreign direct investment incentives compared to other countries. In addition, preferably with private sector participation, they could mount a promotional campaign in major international capital centers highlighting the country's comparative advantages.

Industrial Sector

47. The industrial sector is expected to play an important role in any recovery.9/ This sector has has been experiencing a steady recovery from the fourth quarter of 1985 so that by mid-1986 some sectors such as food products and chemicals had reached capacity utilization levels over 80%. Manufactures of industrial equipment, machine tools, increased 5.7% in the first quarter of 1986 compared to the corresponding period in 1985. However, in sectors such as capital goods with 40% excess capacity, the

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9/ Government intentions are outlined in "Guidelines (Lineamientos) of an Economic Growth Strategy 1985-89", while somewhat more detailed suggestions are offered in Argentina: Strategies Toward Industrial and Export Development, The World Bank, September 1985.

recovery is from an extremely depressed base. Sectors which were heavily dependent on public expenditure have been severely hit while other sectors have recovered to the levels prevailing in late 1984/early 1985. The initial phase of the recovery in 1986 was due to an expansion of credit leading to a recovery in consumer durables (auto, household appliances). Depending on the specific subsector there was substantial usable capacity underutilization which could absorb higher demand in a non-inflationary manner. This enabled the economy to rebound strongly in 1986 so that the industrial sector increased by 12.4% above 1985.

Barriers to Growth

48. The lack of competition and the size of barriers to mobility and growth also explain some investment behavior in Argentina. Most industrial subsectors are characterized by high levels of concentration due in part to the existence of economies of scale and technological barriers to entry; but also due to institutional and policy-determined barriers to growth and mobility. Recent data on concentration are quite scarce. What is available, however, tends to support the proposition that Argentine industry is highly concentrated. Table 10 presents some subsector specific data on concentration ratios. A detailed study of the industrial sector is needed to provide current information on structure, degree of competition, costs, inputs, domestic and external by subsector. This would be useful for making price policies. High levels of concentration combined with such barriers have limited the degree of open and potential competition. This oligopolistic structure also leads to a system of mark-up pricing which contributes to an inflationary spiral. A general opening of the economy should be helpful. However, those who benefit from the rents will tend to resist such changes. Two other policy-induced barriers relate to the system of price controls and of investment incentives (including the "special investment programs") which resulted in distortions in the volume and distribution of investment outlays in specific subsectors due to the introduction of noneconomic criteria (e.g. consumer electronics).[10]

49. The principal factors affecting industrial growth in addition to the institutional factors mentioned in Chapter 3 are the present incentive scheme which has played a major role in the evolution of the market structure noted above. The scheme has tended to use ad hoc procedures with only limited criteria for establishing priorities. The implementing authority has substantial discretionary authority. In recent years, this scheme provides a set of fiscal incentives (tax holidays) which include suspension of value-added tax (IVA), together with direct subsidies aimed at a variety of goals which include, for example, firms willing to locate

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10/ Non-tariff restrictions constitute a barrier to competition. The Government's Trade Policy Reform will remove virtually all quantity restrictions. These provide for curbs on the import of any good that is locally produced, thus affording substantial protection for incumbents. By lowering the degree of market contestability, those barriers retard more progressive technological and marketing conduct on the part of managers and dampen new investment. The Government has taken measures to improve the situation in the informatics sector. Quantity restrictions were replaced by descending tariff protection from 100% to 50% over a 5-year period.

in special areas. Often these incentives are granted for long periods (15-20 years). Besides substantial abuse of the present system it has resulted in generating entry barriers. Some measures were announced in March 1987 to increase productivity. These include exemptions of two years on machinery and equipment imports not manufactured in Argentina and 1-1/2 years for capital goods produced in Argentina but not meeting price and quality requirements. There were also extensions to the temporary admissions regime to provide access to needed inputs (see trade section). These measures should be encouraged and extended.

Recommendation. There is need for clarification of an industrial strategy with complementary roles for the private and public sector. The Guidelines paper (para. 47) could serve as a basis. This should be supported by an incentive system. In particular, the time span for incentives should be reduced so that firms could be obliged to become more efficient and move to international competition (the horizon should be 4-6 years at most). The Government could impose criteria on firms currently (and prospectively) enjoying these privileges to achieve this. Recent efforts by the DGI to clear up some of the abuses should be strongly encouraged.

CHAPTER 5. EXTERNAL BALANCE

50. In the decades prior to 1980, Argentina generated a trade surplus in most years, thanks to success in wheat and beef exports. This surplus had been sufficient to yield a current account that was on average close to balance. However, the ill-fated experiment of the Martinez de Hoz period led to a gradual deterioration in external accounts and to severe external disequilibrium from 1980 onwards. The balance of payments in recent years is given in Table 11. This, in turn, led to one of the principal differences between the Plan Austral and previous stabilization efforts, namely that much of the room for maneuvering has been circumscribed by the external debt situation.

External Debt

51. The previous CEM[11/], January 1985, reviewed the situation during the years 1978 to 1983. In 1978 the public sector debt was US$8.3 billion. The public and publicly-guaranteed external liability in 1985 was US$48.3 billion. There are many factors which contributed to this rapid increase as the ratio of total debt to GDP (Debt/GDP) increased from 28% in 1978 to 75% in 1985. There is also evidence of capital flight, military imports, and various components of the overall debt situation that may have been illegally contracted. In 1982 the public sector took over the debt of much of the private sector to preclude the imminent collapse of the industrial sector. While the debt did increase rapidly, a substantial portion of the proceeds was not used for productive purposes and much of the debt now serviced by the public sector has its counterpart in private sector assets held abroad. This fraction may be anywhere from 25 to 50% of the total debt. Consequently, while the burden of paying the whole debt rests on the country it does not have concomitant assets for much of the debt to help carry the burden.

11/ Argentina Economic Memorandum, The World Bank, 1985.

52. The situation is further complicated when one considers that most of the earning capacity for foreign exchange lies in the hands of the private sector. This means that not only must the country as a whole achieve a big enough transfer abroad to service the debt but within the country the foreign exchange must be transferred from the private to the public sector. This transfer can be carried out either by taxation or by getting the private sector to accept public domestic debt. The debt burden poses a major problem for formulating a medium-term strategy.

53. Interest payments on the stock of debt presently outstanding are about US$4.5 billion per year. If the trade surplus (discussed below) is around US$2.3 to US$3 billion then Argentina will need something of the order of US$1.5 to US$2.0 billion of new money each year. This would imply a growth in the debt of around 3% to 4% per year in nominal US$ terms. If the economy grows at 3-4% real per year then typical debt indices such as debt/GDP ratio would show steady improvement. Any fall in interest rates would accelerate the improvement with each 1% per year drop reducing interest payments by around US$500 million per year as most of the debt is on floating terms. Thus, with growth, the debt service problem would be steadily reduced. This is similar to the Argentine experience with the debt crisis in the late 19th century. The principal lesson from that experience was that the problem was finally resolved only when adequate additional resources for growth were forthcoming. Estimates related to the present situation are given in Chapter 6.

Recommendation. The Government of Argentina could draw up a financing plan that will estimate sufficient resources for the growth pattern envisaged. This, in turn, should incorporate adequate reserves or access to funds to help cushion any of the typical negative shocks, that may be expected, without requiring abrupt policy changes. In the meantime, the Government should consider the advantages and disadvantages of various debt/equity swap arrangements and assess the implications of the discounts available on Argentine debt in the secondary market. This can, however, offer only limited relief because the market is small relative to the total debt outstanding and the negative impact on domestic debt may not be warranted.

Trade

54. Besides the debt and its servicing needs, the other major consideration for external balance is the trade account. Increased investment and a successful trade performance are key elements to a medium-term growth strategy.

55. There are many reasons for the recent stagnation of Argentina exports. These can be divided between external and domestic factors. On the external side, export performance is retarded by international demand conditions. The world market prices for Argentina's major export commodities have fallen precipitously. Between 1981 and 1985 the real declines in international prices for soybeans, sorghum, wheat, and corn have been 25%, 32%, 46%, and 24%, respectively. These four commodities account for over one-third of Argentina's exports. This situation is further compounded by the virtual closure of EEC markets and subsidized exports of competitors. The accord with Brazil offers a number of advantages. It helps towards the opening of the economy not only in terms of merchant trade but also as a conduit for new ideas.

56. Calculations based on data for the period 1970-85 suggest there has been a strong anti-export bias.12/ First, the macroeconomic policy environment has been highly unstable as mentioned in para. 15. For example, the erratic nature of Argentine exchange rate policy in the past (see Table 9) has made producers perceive export activity, not to mention investment for export production, as highly and inherently risky.13/ The lack of overall consensus and policy definition has resulted in very high uncertainty for economic actors and in turn has impeded export growth.

57. In addition to the perceived instability of the economic policy environment, there is the present nature of that policy environment itself. Changes in that policy environment in the direction of reducing such discrimination, particularly of manufactured products, are likely to encourage export growth. The adverse nature of the policy environment towards exports can be seen, and examined, in terms of (a) exchange rate policy; (b) the trade policy regime; and (c) special incentive programs intended to offset the discrimination imposed by other economic policies on export activities. In an overall and more fundamental sense, the policy environment at the onset of the Plan Austral reflects in the view of many producers a lack of a serious commitment on the part of the Government to expand exports. However, many recent initiatives (see below) are beginning to reduce skepticism.

Recommendation. The trade regime is currently being reformed. This effort should continue. In addition to the institutional and macroeconomic components previously discussed, the strategy should seek to: (a) move relative prices to improve Argentina's competitive position in international markets and to provide greater incentives for exportables; (b) eliminate the anti-export biases present in the conduct of present economic policies; and (c) increase automaticity and transparency in the administration of incentive policies. While the policy changes to support a growth strategy based upon export expansion are numerous and interrelated, some policies stand out as central - an appropriate exchange rate policy (with a viable and smoothly functioning system of temporary admissions for export production as an interim solution) and a general reform of the import system.

(a) Exchange Rate Policy. In order to implement a strategy of export expansion and growth, an exchange rate policy should be pursued

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12/ Some exploratory econometric analysis was undertaken using quarterly data for the period 1970-85 to examine the determinants of Argentine industrial exports. Ordinary least squares were used to estimate an export supply function for industrial products. The analysis provided suggestive evidence that: (a) the temporary admissions scheme for export production was significant in expanding exports; and (b) poor domestic demand conditions have encouraged producers to seek out export markets. Recent policy initiatives by the Government have reduced the anti-export bias.

13/ For a discussion of this policy instability, see Julio J. Nogues, "The Nature of Argentina's Policy Reforms during 1976-81," World Bank Staff Working Paper No. 765, January 1986.

in order to assure both the relative price relationshipnecessary to foster tradable goods production in Argentina and the competitiveness of Argentine products in world markets. A stable, as well as an attractive, real exchange rate level is crucial for sustained export growth. As such, the maintenance of a stable and competitive real exchange rate should be a policy objective. In the present context, the Government, at a very minimum, should not permit any further real appreciation of the austral and should move to tilt prices in favor of traded goods. It is also essential to note that any substantial real devaluation will also place a corresponding burden on domestic resource transfers needed to service the foreign debt so that the policy must weigh both sides.

(b) Export Incentive System. Several improvements in the immediate export incentive (disincentive) system are desirable, primarily in order to reduce the existing anti-export biases in economic policies. They are:

(i) Reform of the Temporary Admissions System for Export Production. All restrictions imposed on exporters to imported intermediate goods for export production should be removed. The Government has taken substantial action. In March 1987, it included 3,104 new inputs so that the amplified list has 6,676 positions for the standard TAR system. The temporary admission regime has been further extended to include all inputs from Brazil to be used in exports. Recently the Government has introduced a special TAR system, Argentina Exports (ARGEX), which includes automatic, duty-free access to all imported inputs required in the production of exports encompassing all tariff positions and including capital goods, on the basis of a multi-annual export contract.

(ii) Reduction and Removal of Export Taxes. Most export taxes in manufactured commodities were eliminated in August 1986 in preparation for a trade loan with the World Bank. The remaining taxes on all exports should be gradually phased out. This should be done with due consideration to the impact on public finances.

(iii) Reduction of Export Procedures for Most Products. A simple Export Declaration, employed in many countries, could be instituted for statistical purposes and subject, if desired, to *ex post* verification and control with appropriate safeguards and penalties to prevent abuses.

(iv) Elimination of the Outright Subsidy on the PEEX Program of Special Export Incentives. These programs, negotiated with individual firms, are based on incremental exports over a period of up to five years. Participating firms receive a subsidy of up to 15% of the export increment. The PEEX program is likely to encounter numerous economic and administrative difficulties because it has a high discretionary element and is not transparent. It should not be expanded and its scope should be reduced.

(v) Export Financing. One of the main problems facing exporters is the lack of availability of adequate and timely financing.[14/] This suggests the need for an export credit facility that would operate outside the immediate control of the Government of Argentina to furnish this service. This would seek to provide Argentine exporters with similar support to that of its competitors. Any subsidy element should be phased out.

(vi) Marketing. Most producers in Argentina tend to be product- rather than market-oriented. A number of Argentine producers have been quite successful in adapting to external markets. However, for many firms (especially smaller ones) the initial costs may be prohibitive. For their needs, a public/private unit could be devised. As a first step, it should hire internationally experienced market specialists to analyze the present system and make proposals to facilitate change and then proceed to develop a marketing strategy.

(c) Reform of Import System. In bringing about a significant and lasting reform of the import restriction system three related and simultaneous policy actions are desirable. These changes would be intended to increase competition and productive efficiency. It would be easier to introduce these changes if exports were expanding first. They are:

(i) Reduction of Non-Tariff Import Restrictions. The list of products requiring prior permit should be gradually phased out. This could be done systematically by first freeing the less problematic items and at the same time outlining and announcing publicly the longer term strategy. This would afford firms the opportunity to adjust.

(ii) Tariff System Reform. A comprehensive tariff system should be phased in to replace virtually all import quantity restrictions over a two- to three-year period so that in the medium-term it would result in tariff being the major policy instrument for providing domestic market protection.

(iii) Modernization of Adversely Affected Sectors. To accompany the suggested trade policy reforms a comprehensive program of adjustment assistance (safety net) should be instituted for those firms, and workers, adversely affected. The purpose of this adjustment assistance for firms should be to help them modernize their plant, reequip if they can ultimately compete, restructure their assets, and improve their efficiency. The financing of this program would be a major determinant of the speed with which the reform could be effected.

14/ One administrative procedure is for Government to provide credit in foreign exchange for temporary imports which is to be repaid in foreign exchange after six to nine months. This makes physical verification unnecessary.

58. To bring about the type of policy changes suggested here implies a fundamental change in direction and strategy. Not only does this require a major commitment on the part of the Government and the private sector; it implies substantial technical work as well. To this end it may be desirable to establish a small inter-ministerial Work Group, under the auspices of the Ministry of Economy, to do the necessary analytical and preparatory work for implementing the desired policy reforms.

CHAPTER 6. MEDIUM-TERM POLICIES AND PROSPECTS

59. In this section a set of projections is offered as a base case. Then an alternate scenario is presented and finally a number of risks are considered.

Base Case

60. Based on current policy directions together with some specific assumptions given in Table 12, a set of projections was generated. The fundamental underlying assumption is that the general thrust of the Plan Austral would be continued and there would be no major domestic or external shocks. Later we discuss whether this itself may be a very realistic assumption.

61. On fiscal policy, receipts continue to be strong as tax administration is strengthened; however, the expenditure side is more difficult. As noted, it seems difficult to constrain expenditure on wages, goods and services further in the short run as these have already been cut severely and redeployment of the work force would pose a major political risk in a depressed economy. There may be some relief on interest charges as rates fall lower while another major expenditure heading, capital expenditures, have already been cut to the bone. The one area that may see some improvement is transfers. In particular, it is noted that two major expenditure categories, interest and transfer payments, are to a large extent determined by exogenous factors; then higher GDP growth rates will be associated with a reduction in the fiscal deficit. Rationalization of public sector prices and tariffs can be expected to lead to reductions in transfers to public enterprises as the new technocratic managers assume control while the financial sector reform will lead to reduction of the quasi-fiscal deficit. The proposal in February 1987 to have a monthly budget for rediscounts is a welcome step to try and come to grips with this problem. Even here, results are likely to take time and significant reductions will be difficult during the current election year. The outcome of the present fiscal policy seems on line to produce a deficit close to 4% of GDP for 1986, about half of which may be attributed to quasi-fiscal operations.

62. On monetary policy, the authorities would continue to aim for moderately-positive real interest rates to depositors. As financial reform is introduced, spreads could be reduced but real rates to borrowers would remain over 20% per year in the short-term. This would continue to dampen the enthusiasm of investors in the real economy but could encourage repatriation of some external capital for financial gain. In the medium-term, as these rates fall and finance for both medium-term and working capital becomes cheaper and more readily available, a recovery in private investment could be expected.

63. Wage policy would seek to maintain current real wage levels by striking a balance between union pressure on the one hand and the need for increased competitiveness as well as moderate inflationary expectations on the other. Profitability gains would come from increased efficiency. Prices of key items would continue under surveillance and the general system of price controls would be removed progressively as inflationary pressures ease. Paradoxically, the extremely poor record in Argentina on productivity over recent decades suggests that substantial gains may be obtained here. The notable international success of many Argentines in areas such as medicine, economics, bio-engineering stands in stark contrast to the ability to introduce updated technology in the economy at large. This warrants further study.

64. The crucial issue for exchange rate policy is to maintain a competitive real effective exchange rate through reduction of the anti-export bias and adjustment of the nominal exchange rate. Because of the present export orientation it will require some time to convince producers to make appropriate investment and update their technology. As indicated in the previous chapter, fixing the nominal Austral to the U.S. dollar turned out to have been quite fortuitous in the early part of the Plan Austral. Then as the dollar depreciated the authorities moved to a form of crawling peg regime from April 1986 onwards. This modified the impact of domestic inflation on the real exchange rate. A crucial question is whether this is indeed the correct level. One line of argument is that a sharp devaluation would send a strong signal that traded goods were to be encouraged. On the other hand it is likely to increase inflation. Argentina has a relatively open capital market and a well-informed labor movement, so that it would be extremely difficult to engineer a major real exchange rate devaluation. Given the high debt level (around 75% of GDP) a successful real devaluation would, in fact, necessitate a proportionately larger real domestic resource transfer to meet service payments. Yet, one of the few avenues for expansion of the economy should be through export growth. In order to favor exports whose expansion is crucial to growth of the economy there is a need to ensure a real depreciation over the medium-term especially in terms of the US dollar. This would be facilitated by elimination of the anti-export bias together with a well-conceived import liberalization strategy. If this were made public it could help convince potential exporters to orient themselves towards external markets and generally channel resources into traded goods sectors. It would help reinforce current attempts to open the economy.

65. Key variable projections are given in Table 13 for the base case scenario. The real GDP growth is expected to stage a mild recovery to 4% in 1987 and then continue at around 3.7%. This would be led by recovery in the industrial sector through improved availability of intermediate and capital goods. In 1986, agriculture suffered from unfavorable weather conditions on the domestic side while in external markets it continues to suffer from poor access and depressed prices. Underlying these projections is the assumption that the public investment share will show a modest increase in line with fiscal constraints while private investment will begin a more robust recovery after two to three years. This is predicated on continued reduction in the fiscal deficit, improved efficiency in parastatals, stronger private sector role, steady policy reform in the financial sector so that more funds at appropriate rates are available for investors, and on a systematic move to a more open trade regime.

66. Balance of payments projections are given in Table 14. The current deficit in 1987 is projected at close to US$2 billion, or slightly better than the 1986 level of US$2.6 billion. The deterioration in 1986 from the 1985 level of under US$1 billion was largely because of a reduction of US$600 million in value for cereal exports. About 80% of this fall may be attributed to reduced prices while the remainder is due to decreased volume, due to weather conditions and increasingly tough competition due to European and U.S. subsidies. On the import side in 1987, intermediate goods, at US$3.7 billion are expected to be more than US$1 billion higher than the severely constrained levels of 1985. Some of the deterioration on the trade account is offset by lower interest payments due to lower interest rates.

67. Total debt outstanding is projected in Table 13 to show modest growth in current US dollars through the 1990s. However, various credit indicators such as debt/exports, debt/GDP are expected to show steady improvement. The debt rescheduling assumptions are given in Table 12 and should be viewed as indicative of one possible outcome. The situation could be much improved by further reductions in interest rates or significant private capital inflows of either new or repatriated funds.

68. The set of projections discussed above do not assume any shocks, historically an unusual situation. Even so, underlying these projections is a growth in consumption per capita of around 1% per year. Following the major setbacks in per capita income in recent years, the 1986 level is about 10% below the 1970 level.

69. The recovery of the economy from the low point of 1985 together with a continuation along the lines of the base case scenario suggest a medium-term annual growth rate around 3.7% of GDP. Even this will result in average per capita consumption levels recovering to their 1980 levels only by 1990. Some consideration should be given to the possibility of improving the prospects by a carefully targeted short-term increase in public investment levels in 1987 and 1988. This should be associated with a reallocation of public investment priorities.[15/]

70. By way of illustration, we introduce a high case. The main differences between this and the base case are: a faster pace of policy reform and a level of public investment 1% of GDP higher leading to a stronger export performance. This stronger export performance would come from lower costs through efficiency gains and a reduced anti-export bias. The chosen activities for investment would have to meet the criteria outlined in Chapter 4 on investment. The financing of such a boost is critical and in particular, analysis of the impact on public finances and the balance of payments. Some of the key projections are given in Table 15. These projections assume that the public sector deficit is financed by additional external financing as shown in Table 16. The additional financing required may actually be less than indicated as fiscal receipts may be higher in a more buoyant economy. The consequences may be summarized as follows.

15/ A detailed analysis of public investment is given in Argentina Public Sector Investment Review, op. cit.

- Growth Rate — Growth rates for GDP consumption and investment are higher than the base case. This would also imply an employment benefit. It is also important to note that the higher growth would help reduce the deficit. Revenue would rise with growth while expenditures on transfers and interest payments would not increase as rapidly.

- Debt — Total debt outstanding and disbursed in the high case scenario would be US$700 million higher in 1988, US$1.1 billion higher in 1989. The debt service ratios would be better by 1992 and improve more rapidly for the high case due to the higher growth of exports.

- Inflation — In the short-term, there is some deterioration of the public sector deficit. However, it is important that the message be conveyed by the economic team to the population at large (and supported by action) that the increase in the deficit is for investment required for growth and is financed by additional external flows to facilitate imports and not by printing money. In the medium-term, the improvement in the deficit will have a reduced impact on inflation.

- Private Sector Investment Response — Because of increased public investment one expects a traditional positive response by private investors. Their response is expected to show steady improvement as credibility of the program is reinforced. Thus investment as a share of GDP is conservatively assumed 0.5% higher by 1990 than in the base case.

- Credibility — Credibility can be improved by making the public aware of what the program is expected to achieve and in particular how it will be financed. At the same time it is important to outline the complementary fiscal performance envisaged. In the illustrative high case scenario presented here, the deficit is improved both on the expenditure side by reduced transfers to public enterprises and on the revenue side by the assumption of a steady increase in the receipts for the VAT tax from 2.9% of GDP in 1986 to 3.7% in 1991. This could be achieved by broader coverage, improved collection possibly combined with lower rates to reduce evasion.

It is important to consider the possibility of inflationary excess demand pressures. As typically about 50% of public investment expenditure goes to construction, this would create a substantial increase in activity for that sector. However, the sector is one of the most depressed, accounting for only 3.8% of GDP compared with average levels of 6.5% in the 1970s so that inflationary pressures from this source should be minimal. Perhaps the principal risk is that such an increase might be seen by some groups as a slackening of various reform efforts on expenditure. This would need careful attention so as not to reignite inflationary expectations.

Risks

71. Finally, we mention a number of risk factors that could have a major impact on the base case scenario (and a fortiori on the high case scenario).

(a) Domestic Concerns. Perhaps the major consideration is that the momentum of the Plan Austral be sustained and that the Government bring inflation down without renewed recession. This, in turn, requires a judicious balance between a healthy growth and a responsible fiscal and monetary policy and a smooth transition to freer prices and wages. The thrust of present policy together with adequate external financing could ensure this. Smaller real external flows would pose a difficult dilemma for policymakers as they would then be obliged to trade off growth and low inflation rates, especially in the short-run.

(b) High Case Scenario. In the high case scenario additional external financing is predicated for the first few years. This should be used to support higher public investment level (through increased imports) to improve production and, in particular, export capacity of the nation over the medium term. It is essential that, if such financing becomes available, it should not be used for nonproductive purposes but rather to speed up the pace of structural reforms.

(c) Interest Rates. As noted, the external debt level around US$50 billion, each 1%/year reduction (increase) in interest rates (and margins) would reduce (increase) the total interest burden by US$500 million per year. Thus, full use should be made of financial engineering to try to moderate the impact on the broad thrust of economic development.

(d) Export Prospects. Any slowdown in OECD growth would have a negative impact on export prospects. A crude estimate of Argentine export elasticity is 2.2 with respect to OECD growth so that a slowdown in GDP in those economies of about 1% per year could be reflected in a loss of exports of US$200 million per year. However, at a less aggregate level, manufacturers are more likely than agriculture to be effected by such changes.

(e) Terms of Trade. There is a need to diversify exports including agricultural exports. Surpluses in major grain suppliers such as the U.S. and Europe together with increasing self-sufficiency ratios in major markets such as the Soviet Union, China and India does not augur well for near-term prospects to traditional Argentine exports. Serious consideration is needed for a major restructuring of agriculture to meet changing demand patterns in world markets. The newly available markets in Brazil may provide some time to cushion the transition but inevitably this market will also fluctuate as that country's economic fortunes change.

Table 1

SUMMARY OF KEY MACROECONOMIC AGGREGATES, 1978-86

	1978	1979	1980	1981	1982	1983	1984	1985	1986 prelim.
GDP Growth Rate	-3.4	6.7	0.7	-6.2	-5.2	3.3	2.5	-4.8	5.5
Debt/Export Ratio /a	1.6	2.2	2.5	3.1	4.6	4.7	4.7	4.7	5.6
Interest/Export Ratio (%) /b	15.2	16.5	20.2	33.3	51.7	57.0	55.2	50.1	48.9
Total Debt/GDP (%) /c	28	35	43	56	70	70	69	75	70
Interest Payments/GDP (%) /d	2.6	2.6	3.5	6.0	7.9	8.4	8.1	7.9	6.1
Debt Service Ratio (%) /e	59	33	43	63	89	140	99	79	76
Terms of Trade /f	78	83	94	107	92	88	95	83	74
Import Growth Rate /g	-4.9	45.4	45.4	0.4	-41.2	-2.4	3.5	-12.4	6.8
Export Growth Rate /g	12.2	-3	-4.9	5.9	-2.4	11.5	4.4	8.0	-12.5
Current Account Balance (US$m)	1833	-537	-4767	-4714	-2357	-2461	-2391	-953	-2645
Total Debt (US$m)	12496	19034	27162	35671	43634	45087	46903	48312	49073

/a Total debt including short-term/exports goods and NFS; absolute ratio.
/b Total interest payments to exports good and NFS.
/c Total debt including short-term/GDP.
/d Total interest payments/GDP.
/e Total interest and amortization on MLT divided by exports of goods and non-factor services.
/f Base 1970 = 100.
/g Real growth rates in 1970 prices.

Source: Central Bank.

Table 2

INDICATORS OF INCENTIVES AND EXTERNAL TRADE, 1978-86

	1978	1979	1980	1981	1982	1983	1984	1985	1986 6/
Real Effective Exchange Rate									
Index (1970=100)	97.7	133.2	155.9	120.2	94.3	97.1	107.5	90.6	79.9
Annual change	11.1	36.3	17.0	-22.9	-21.5	-3.0	10.7	-15.7	-11.8
Real Interest Rates 1/									
Deposit Rate	-1.5	1.2	1.1	-1.0	-5.6	-3.0	-4.0	-2.5	-1.5
Lending Rate	-0.1	0.2	2.0	0.7	-4.6	-2.1	-2.6	-0.8	1.5
Index of Real Wages (1980=100) 3/	80.3	83.6	100.0	114.3	109.9	159.0	167.6	124.5	117.8
Ratios of Domestic Energy Prices to International Prices 4/									
Gasoline	2.4	2.0	2.6	1.8	0.9	1.4	2.3	2.2	n.a.
Kerosene	..	..	..	..	0.3	0.6	0.6	0.7	n.a.
Gas Oil	1.8	1.1	1.6	1.2	0.5	0.9	0.8	0.9	n.a.
Fuel Oil	..	..	..	0.6	0.3	0.7	0.6	0.8	n.a.
Volume Index of Exports (goods)									
Index (1980=100)	118.0	114.4	100.0	113.2	110.4	126.0	123.4	143.3	126.8
Growth rate	9.4	-3.1	-12.6	13.2	-2.5	14.1	-2.1	16.1	-11.5
Trade Value (% of world total)									
Exports	0.53	0.51	0.43	0.49	0.44	0.47	0.46	0.47	0.36
Imports	0.31	0.43	0.55	0.49	0.30	0.26	0.25	0.20	0.23
Manufactured Exports 5/									
Real growth rate	-1.1	9.7	-6.6	4.5	-6.4	-10.0	9.8	17.4	-12.3
Value as share of total exports	58.9	59.5	59.1	54.4	60.2	51.4	56.7	56.0	55.5
Commodity Terms of Trade									
Index (1980=100)	83.5	88.4	100.0	113.8	98.5	94.1	101.7	88.8	78.4
Annual change	-10.0	5.9	13.1	13.8	-13.4	-4.4	8.0	-12.7	-11.7

1/ Monthly average of regulated interest rates, 30 days.
2/ Corresponding values are -5.7% for the first half of 1985, and 4.15% for the second half.
3/ INDEC, Real Industrial Wages, average of official blue collar.
4/ Domestic prices obtained using the official exchange rate.
5/ Includes manufactures of agriculture and industrial origin.
6/ Preliminary.

Source: Central Bank.

Table 3

RECENT INDICATORS, 1985-1987
(Selected Data)

	1985								1986												1987			
	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	March	April/e
CPI /a	25.1	30.5	6.2	3.1	2.0	1.9	2.4	3.2	3.0	1.7	4.6	4.7	4.0	4.5	6.8	8.8	7.2	6.1	5.3	4.7	7.6	6.5	8.2	3.4
WPI /b	31.2	42.3	-0.9	1.5	0.6	0.7	0.7	1.0	0.0	0.8	1.4	3.0	2.7	4.6	5.1	9.4	6.8	5.3	4.9	3.0	5.3	6.9	7.8	1.9
Exchange Rate per US$ (monthly averages)																								
Official	.525	.747	.801	.801	.801	.801	.801	.801	.801	.801	.801	.828	.849	.873	.903	.965	1.050	1.094	1.150	1.214	1.293	1.377	1.487	1.541
Parallel	.621	.802	.946	.953	.941	.925	.903	.855	.899	.861	.911	.923	.904	.896	.916	1.090	1.226	1.210	1.350	1.570	1.634	1.735	1.891	2.049
Parallel Official	1.18	1.07	1.18	1.19	1.17	1.15	1.12	1.07	1.08	1.08	1.14	1.12	1.06	1.03	1.01	1.13	1.17	1.11	1.17	1.29	1.26	1.26	1.27	1.33
Real Effective /d	44.8	40.2	39.4	39.3	40.2	40.4	41.7	43.2	43.6	43.9	43.6	43.6	43.1	43.3	44.6	44.1	43.1	44.8	46.4	46.5	45.7	45.4	n.a.	n.a.
Interest Rates (monthly)/b																								
Regulated lending rate	32.0	18.0	5.0	5.0	5.0	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.7	5.0	6.6	6.0	6.5	7.0	7.0	7.0	6.8	4.0	8.2
Free-Interfirm	34.1	21.4	8.1	8.2	7.7	6.5	6.6	6.7	6.7	6.7	4.9	4.8	4.9	4.7	5.3	6.7	7.4	8.2	8.3	9.3	9.1	8.7	4.5	8.4
Real wages /c	84.6	79.4	74.8	72.6	71.1	69.8	68.2	66.1	67.4	66.3	70.6	76.5	78.9	79.1	85.0	78.1	72.9	75.2	71.4	68.2	69.1	n.a.	n.a.	n.a.

/a INDEC, percentage change during the period. CPI (1974=100) and WPI (1981=100).
/b Commercial banks 30 days money lending rates.
/c INDEC, Real Industrial Wages, average of official blue collar (1983=100).
/d IMF (seasonally adjusted): 1980 = 100.

Table 4

STRUCTURE OF THE FINANCIAL SYSTEM'S ASSETS & LIABILITIES
(December 1985)

Assets	As a % of Total Deposits	Yield (in %) per month	Liabilities	As a % of Total Deposits	Yield (in %) per month
1. Required Reserves on Demand Deposits	23.6	0.0	1. Regulated Deposits	61.2	1.5
			1.1 Demand Deposits	26.5	0.0
2. Required Reserves on Time Deposits	3.5	0.0	1.2 Time Deposits	34.7	2.7
			a. Time Regulated		
3. Bonin	4.6	4.0	. 7-14 days	4.3	2.3
			. 15-22 days	1.5	2.4
4. "Deposito Indisponible"	28.3	4.0	. 23-30 days	0.5	2.5
			. +30 days	11.0	3.1
5. Regulated Loans	1.3	4.5			
			b. Savings Deposits		
			. Regular	13.6	2.3
			. Special	3.8	3.1
6. Required Reserves on Free Deposits	2.8	0.0	2. Free Deposits	37.4	5.0
7. Bonor	15.7	5.0			
8. Free Loans	18.9	7.2			
9. Indexed Loans	7.3	2.5	3. Indexed Deposits	1.4	2.3
			3.1 Indexed to Domestic Inflation	1.2	
			3.2 Indexed to US$	0.2	
			4. Rediscount to Support Indexed Operations	6.0	2.3
			5. Total Deposits	100.0	-
10. Rediscounted Loans	37.0	3.1	6. Rediscounts	37.0	2.8
11. Free Loans	10.5	7.2	7. Equity	42.0	-
12. Fixed Assets	31.5	-			

Source: Banco Central.

Table 5

TAXATION FOR CORPORATION
(Selected Example of Fiscal Complexity - as of November 1985)

Tax	Object	Rate	Remarks
Income tax	Taxable income in Argentina	45% non-resident; 35% resident	Prepayments system
Taxes on capital	Net worth	1.5%	" "
V.A.T.	At all stages	18%	5% - foodstuff 25% - custom man., etc.
Stamp duty	Contract amount	1%	0.5% - 5%
On purchase/sale of foreign exchange	Transaction amount	0.6%	Withheld by Bank/
On current account	Account	0.2%	Withheld by Bank
Excise tax	Various products	70%	
On gross revenue	Gross receipt	3% (B.A.)	By cities & provinces 1-15%
On transfers of securities	Transaction amount	0.75%	
On land & property	Assessed valuation		Rates vary
Inspection tax	-	A5-102	Annually
Social security	Gross salary of employees	10.5% 9% 4.5% 5%	Pension Fund Family Subsidy Fund Health Scheme National Housing Fund
Forced savings	-	-	40% of indexed figure based on income tax.

Source: Mission estimates.

Table 6

BALANCE OF SAVINGS, INVESTMENTS & INTEREST PAYMENTS
(% of GDP)

	1972	1977	1982	1983	1984	1985	1986 est.
Private Sector							
Saving (Sp) (Non-Interest Current A/C)	19.0	19.1	18.4	23.1	20.9	14.3	9.7
Transfer-foreign (Tfp) /b	0.6	0.3	0.9	2.3	3.1	2.1	0.9
Transfer-domestic (Tdp) /c	-0.6	-1.4	-6.5	-1.0	-0.8	-0.8	-0.9
Investment (Ip) /a	13.7	13.2	9.9	7.8	8.5	6.8	7.4
Net	5.3	7.0	14.1	14.0	10.1	6.2	2.3
Public/Govt. Sector							
Saving (S_g) (Non-Interest Current A/C)	4.0	8.0	1.3	-4.4	-3.9	3.8	6.7
Transfer-foreign (Tf_g) /b	0.5	0.6	5.2	5.0	4.2	4.7	4.7
Transfer-domestic (Td_g) /c	0.6	1.4	6.5	1.0	0.8	0.8	0.9
Investment (I_g)	8.5	11.1	6.7	6.4	3.9	3.8	4.5
Net	-5.6	-5.1	-17.1	-16.8	-12.8	-5.5	-3.4
External/Foreign Sector							
Saving (Sf) (Trade Deficit)	-0.8	-2.8	-3.1	-4.5	-4.6	-7.5	-4.5
Transfer (Net FSY) /b	-1.1	-0.9	-6.1	-7.3	-7.3	-6.8	-5.6
Net	0.3	-1.9	3.0	2.8	2.7	-0.7	1.1
Total Balance	0	0	0	0	0	0	0
Memo Items:							
Gross Investment/GDP	22.3	24.3	16.6	14.2	12.4	10.6	11.9
GDP (US$ billion) /d	23.2	43.6	62.0	64.8	68.0	64.8	70.0

/a Including changes in inventories. Investment uses BCRA, National Accounts, definition. This differs from that used by Ministerio de Economia in its public sector accounts.
/b Interest and net direct investment income.
/c Interest payment on debt by public sector to private sector.
/d 1983 GDP converted at official rate and then adjusted by GDP real growth rate and U.S. wholesale price index for the other years.

Sources: Tables 2.6, 2.8, 3.3 and 5.2 of the Statistical Appendix.

Table 7

NON-FINANCIAL PUBLIC SECTOR FINANCES, 1983-86
(as % of GDP)

	1983	1984	1985 /a Quarters I	II	III	IV	1985 Total Year	1986 /b Quarters I	II	III	IV	1986 Total Year
Expenditures												
Wages and Salaries	9.32	9.92	8.56	9.30	9.11	9.70	9.29	8.87	9.17	8.55	8.79	8.83
Goods and Services	2.18	2.06	1.49	1.77	2.25	2.70	2.21	2.19	2.51	2.52	2.71	2.52
Transfers to Public Enterprises	1.54	1.56	3.21	2.82	0.57	1.75	1.79	1.19	0.17	-0.65	1.24	0.48
Other Transfers	9.84	8.44	7.93	7.24	9.13	9.66	8.73	9.13	8.87	9.39	9.51	9.27
Pensions	7.03	7.22	6.23	5.42	7.16	7.32	6.70	6.87	6.53	7.06	7.13	6.93
Others	2.81	1.22	1.70	1.81	1.97	2.34	2.03	2.26	2.34	2.32	2.38	2.33
Capital Expenditures /c	7.88	6.06	5.26	5.16	5.91	7.28	6.13	5.22	5.06	5.03	5.61	5.26
Interest /d	3.50	2.91	2.94	3.21	2.46	3.82	3.15	2.58	2.83	1.83	2.24	2.32
Other Expenditures	0.45	0.28	0.05	-0.01	0.19	0.60	0.26	0.07	-0.04	0.25	0.22	0.14
Total	34.72	31.24	29.43	29.49	29.62	35.50	31.56	29.26	28.57	26.93	30.31	28.81
Receipts												
Tax Resources (a+b+c)	17.09	17.17	16.09	17.38	21.71	23.32	20.62	20.54	21.80	21.51	18.17	20.32
a. National	12.20	11.14	9.45	9.59	14.49	16.36	13.42	12.24	14.31	13.94	11.29	12.85
b. Provincial	2.68	3.48	3.41	4.48	3.12	3.43	3.57	3.80	3.63	3.30	3.11	3.41
c. Social Security System	2.21	2.54	3.24	3.31	4.11	3.53	3.63	4.50	3.85	4.27	3.77	4.06
Non-Tax and Capital Resources	4.92	3.80	3.19	3.15	3.94	7.63	4.92	3.44	3.54	2.95	4.49	3.66
Other Taxes (with specific uses)	1.55	1.96	2.12	1.10	1.84	2.14	1.80	1.96	2.74	2.43	3.79	2.85
Total	23.57	22.93	21.40	21.63	27.50	33.09	27.35	25.94	28.08	26.89	26.45	26.83
Deficit	11.15	8.31	8.03	7.86	2.12	2.41	4.21	3.32	.49	.04	3.96	1.98

/a Executed preliminary figures.
/b Preliminary.
/c Ministry of Economy definition.
/d National and provincial government.

Table 8

FINANCING THE PUBLIC SECTOR DEFICIT
(approximate estimates, all values expressed as % of GDP)

			Financing Alternatives		
		Inflation Rate (annual)	27%	43%	60%
		(monthly)	2%	3%	4%
I.					
d non-interest deficit	0	B increase in domestic debt	0.50	0.50	0.50
INT_d interest - domestic	0.50	INF inflation tax	1.45	1.99	2.51
INT_f interest - foreign	3.08	SEIG seignorage	0.22	0.19	0.17
		F increase in external debt	1.41	0.90	0.40
Deficit Consol. Public Sector	3.58		3.58	3.58	3.58
II.					
d	-1.58	B	0.50	0.50	0.50
INT_d	0.50	INF	1.45	1.99	2.51
INT_f	3.08	SEIG	0.22	0.19	0.17
		F	-0.17	-0.68	-1.18
Deficit Consol. Public Sector	2.00		2.00	2.00	2.00

Assumptions: Real annual interest rate, domestic 2%.
Real annual interest rate, foreign 4%.
Growth rate of economy, 4%.

Source: Mission estimates.

Table 9

REAL EFFECTIVE EXCHANGE RATE, 1970-86

Comparison of REER Calculations (financial and commercial rates)
IMF method except using WPI

	Austral= Fin. Rate REER-F 1/ Index (1970=100)	Austral = Comm. Rate REER-C 1/ Index (1970=100)
1970 Q-1	98.9	98.9
Q-2	101.3	101.3
Q-3	95.6	95.6
Q-4	106.0	104.0
1971 Q-1	111.0	111.0
Q-2	115.2	115.2
Q-3	106.2	110.2
Q-4	70.1	110.1
1972 Q-1	70.4	134.9
Q-2	77.7	153.2
Q-3	86.5	172.3
Q-4	93.2	186.0
1973 Q-1	106.1	211.8
Q-2	103.9	207.3
Q-3	100.2	199.9
Q-4	103.1	205.8
1974 Q-1	96.2	192.0
Q-2	98.5	196.5
Q-3	106.2	211.9
Q-4	112.3	224.1
1975 Q-1	113.3	198.6
Q-2	91.2	121.7
Q-3	88.7	112.0
Q-4	90.4	126.2
1976 Q-1	72.6	38.2
Q-2	62.8	62.8
Q-3	72.0	72.0
Q-4	82.2	82.2
1977 Q-1	88.0	88.0
Q-2	84.5	84.5
Q-3	89.0	89.0
Q-4	90.0	90.0
1978 Q-1	88.1	88.1
Q-2	93.7	93.7
Q-3	100.3	100.3
Q-4	108.6	108.6
1979 Q-1	118.6	118.6
Q-2	128.6	128.6
Q-3	142.7	142.7
Q-4	143.0	143.0
1980 Q-1	150.9	150.9
Q-2	149.3	149.3
Q-3	156.5	156.5
Q-4	167.2	167.2
1981 Q-1	164.2	164.2
Q-2	133.1	139.6
Q-3	96.4	134.0
Q-4	86.9	125.9
1982 Q-1	113.2	113.2
Q-2	106.2	106.2
Q-3	65.6	101.8
Q-4	92.1	90.7
1983 Q-1	89.9	89.9
Q-2	92.4	92.4
Q-3	102.6	102.6
Q-4	103.4	103.4
1984 Q-1	98.0	98.0
Q-2	112.8	112.8
Q-3	116.7	116.7
Q-4	102.6	102.6
1985 Q-1	96.3	96.3
Q-2	97.9	97.9
Q-3	85.8	85.8
Q-4	82.5	82.5
1986 Q-1	79.7	79.7
Q-2	80.1	80.1
Q-3	80.0	80.0
Q-4	n.a.	n.a.

Notes:

1/ REER = A Real Effective Exchange Rate index
(= A trade weighted purchasing power parity exchange rate index)

Wi * ln [(WPIar/WPIi) * (NERi/NERar) * 100]

REER = e

where:

Wi = trade/export weight for Country-i in Argentine trade/export
WPIar = Argentina's Wholesale Price Index
WPIi = Country-i's Wholesale Price Index
NERar = Argentina's Nominal Exchange Rate index, with Austral relative to US$
NER_i = Country-i's Nominal Exchange Rate index
with the currency expressed relative to US$

An increase (decrease) in index indicates a real appreciation (depreciation) in Argentina's currency.

Countries are selected basing upon detailed trade data during 1982, 1983 and 1984. Each weight is decided considering magnitude of representation of these countries in Argentine trade with U.S. weight adjusted to include socialist trade.

weights:

W US	=	0.30
W Netherlands	=	0.25
W Brasil	=	0.15
W Germany	=	0.10
W Italy	=	0.10
W Japan	=	0.10
		1.00

Sources: IFS/FIEL/INDEC and mission estimates.

Table 10

PRODUCT CONCENTRATION RATIOS

Product	C1 /a	C2 /a	C3 /a	C4 /a	C8 /a	Year
Food products:/e						1983
Sugar	17	29	37	44	63	
Flour	17	26	32	37	49-C7	
Pasta	33	63	76	86	96-C6	
Mayonnaise	35	68	83			
Meat processing	4	7	9	11	18	
Cellulose paste /b	24	43	54	65	86	1983
Paper /b	19	31	43	52	73	1983
Basic chemicals: /b						1983
Sulphuric acid			80		100-C6	
Caustic soda	42	69	81	85	100	
Chloride					100-C7	
Petrochemicals:/f						1983
Manmade fibers: /e						1983
Cellulose acetate	90					
Textile polyamide	58	83	93	100		
Industrial polyamide	90	100				
Continuous polyester	33	50	60	68		
Cut polyester	42	81				
Acrylic	90					
Polyurethane	100					
Polypropilene	100					
Cotton textiles /b	37	60				1983
Wool textiles /e	28	48	64	73	86-C6	1983
Steel /d	22	42	61	70	82-C6	
Pipes /b						1986
Pipelines	70	100				
Electrical tubing					100-C6	
Steel pipes				100		
Washing machines /c	40	60	70			1983
Refrigerators /c	20	40	55	65	75-C5	
Automotive: /e	30	55	80	96	100	1984
Passenger cars /e	29	62	87	100		1983

/a Percent shares in total of largest firm (C1), the top two firms (C2), for example in sugar the top firm has 17% of total production volume, the top 2 firms have 29% of total, etc.
/b Installed capacity.
/c Sales value.
/d Production value.
/e Production volume.
/f Out of 49 main petrochemical products manufactured in Argentina, 30 were produced by a single firm (C1=100), a pure monopoly; 5 by 2 firms (C2=100); 10 by 3 firms (C3=100); 2 by 4 firms (C4=100); and 2 by 6 firms (C6=100). These concentration ratios were for installed capacity.

Source: G.F. Macroeconomia and industry associations.

Table 11

BALANCE OF PAYMENTS
(in millions of US $)

	1983	1984	1985	1986 1/
Exports FOB	7836	8107	8396	6987
Agricultural goods	3810	3771	3713	2904
Manufactured goods of agric. origin	2639	2868	2454	2316
Manufactured goods of industrial origin	1386	1468	2229	1767
Imports CIF	4564	4585	3814	4700
Consumer goods	393	174	204	278
Intermediate goods	3073	3318	2600	3367
Petroleum	458	484	400	305
Capital goods	640	609	610	750
Trade Balance	3272	3522	4582	2287
Real Services (net)	-341	-204	-231	-515
Financial Services	-5408	-5712	-5304	-4422
Interest payments	-5423	-5537	-5132	-4302
Interest income	440	264	253	364
Benefits and dividends	-425	-439	-425	-484
Transfers	16	3	0	5
Current Account	-2461	-2391	-953	-2645
Direct Investment	183	268	919	574
Balance of Payments	2522	2388	898	1103
Change in Reserves	-244	-265	-864	968
External Debt	45087	46903	48312	49073

1/ Preliminary.

Source: Central Bank.

Table 12

KEY ASSUMPTIONS USED IN BASE CASE PROJECTIONS, 1983-92 1/

	1983	1986	1987	1988	1989	1990	1991	1992
Average Export Price 2/	100	89.1	90.0	100.3	108.2	112.6	116.5	120.5
Average Import Price 2/	100	106.8	108.0	116.6	121.2	119.4	122.8	126.4
Terms of Trade Index	100	83.4	83.3	86.0	89.3	94.3	94.9	95.3
Import Elasticity	..	1.2	2.3	1.7	1.6	1.5	1.3	1.3
Population	29.6	31.1	31.6	32.1	32.6	33.1	33.6	34.2
LIBOR (annualized 6-months)	9.0	6.8	7.0	8.0	8.5	9.0	8.5	8.0
Exports (real % growth rates)	..	-11.5	9.6	2.8	3.7	3.1	3.1	3.1
Cereals	..	-25.0	0.2	2.5	2.5	2.5	2.5	2.5
Other Agricultural Products	..	0.3	6.0	3.3	3.2	3.2	3.1	3.2
Fats and Oils	..	29.6	-7.7	-4.5	8.2	2.9	3.0	3.0
Manufactures	..	-15.3	23.8	4.5	3.6	3.4	3.4	3.4

1/ Assumptions:

a- Interest rates: IBRD & IDB for 1986-87, 8.5% and 8.9% respectively; Bilaterals 9.1% from 1986 onwards; private sources M&LT 13/16 over LIBOR, short-term and reserves 1.2% over LIBOR.

b- Rescheduling terms: 7 year maturity, 3 year grace. All existing private source M&LT debt is rescheduled continously. In 1986 $ 741 million dollars in arrears are paid and short-term is converted into M&LT debt which is also rescheduled continously.

c- $ 4013 mill. dollars of total debt owed to Bilaterals is rescheduled, 10 year maturity, 5 year grace, of which 10% of the amortizations due plus capitalized interests are paid during the grace years and the rest is paid during the repayment period.

2/ US dollar index.

Source: World Bank and mission estimates.

PROJECTIONS OF KEY VARIABLES, 1985-1995, BASE CASE SCENARIO
(percentages and 1985 U.S. Dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
GDP growth rate	-4.8	5.3	4.1	3.7	3.8	3.8	3.8	3.7	3.7	3.7	3.7
GDP/capita	2069	2149	2201	2246	2294	2345	2395	2443	2494	2545	2598
GNP growth rate	-4.5	8.8	4.4	4.4	4.0	3.6	4.1	4.0	4.0	4.0	3.9
GNP/capita	1894	2028	2083	2141	2190	2234	2289	2342	2397	2454	2509
US GNP deflator (1985=100)	100.0	102.6	104.7	108.3	112.1	116.0	120.1	124.3	128.6	133.1	137.8
Argentine GDP deflator (US $)	100.0	102.4	105.4	109.1	112.9	116.9	121.0	125.2	129.6	134.1	138.8
Private Investment/public investment 1/	1.3	1.1	1.2	1.3	1.3	1.3	1.4	1.4	1.4	1.4	1.4
Public Investment/GDP (%) 2/	6.1	5.3	5.6	5.9	6.2	6.5	6.8	7.1	7.4	7.7	8.0
Private Investment/GDP (%) 2/	4.5	6.6	6.6	7.4	8.1	8.7	9.2	9.8	10.3	10.9	11.4
Gross Domestic Savings/GDP (%) 3/	17.3	14.4	15.2	16.5	17.5	18.8	19.4	20.1	20.8	21.6	22.3
Exports Growth Rate 3/	8.0	-12.5	11.4	2.9	3.6	3.1	3.1	3.1	3.1	3.1	3.1
Exports/GDP (%) 2/	15.8	12.6	13.3	14.0	14.5	14.3	14.1	14.0	13.9	13.8	13.7
Imports Growth Rate 3/	-12.4	6.8	9.3	6.2	6.2	5.6	5.8	4.2	4.6	4.7	4.6
Imports/GDP (%) 2/	9.1	10.0	10.3	11.0	11.3	10.9	10.9	11.0	11.0	11.0	11.0
Exports of Goods & NFS (mill) 2/	10242	8797	9939	11294	12502	13234	14080	14983	15947	16976	18075
Imports of Goods & NFS (mill)2/	5891	7025	7750	8856	9752	10100	10896	11729	12594	13525	14510
Current Account Balance 2/	-953	-2645	-2227	-1869	-1707	-1570	-1494	-1395	-1229	-1053	-1036
Total debt outstanding & disbursed (mill) 2/	48312	49073	51636	53304	54971	56312	57985	59320	60165	60809	61409
Total debt real (mill. 1985)	48312	47829	49318	49219	49037	48717	48281	47723	46785	45687	44564
Average interest charge	10.6	8.8	8.1	7.9	8.3	8.7	8.3	8.0	7.8	7.5	7.6
Debt/GDP (%) 2/	74.6	70.1	68.9	66.2	63.6	60.9	58.1	55.4	52.4	49.3	46.4
Interest Payments/GDP (%) 2/	7.9	6.1	5.6	5.3	5.3	5.3	4.8	4.5	4.1	3.7	3.5
Interest Coverage Ratio 4/	0.85	0.41	0.53	0.58	0.60	0.64	0.66	0.68	0.72	0.76	0.77
Debt Service Ratio (%) 5/	79.5	75.9	64.1	50.9	55.5	59.5	60.6	58.9	56.9	54.5	53.7
Debt/exports	4.7	5.6	5.2	4.7	4.4	4.3	4.1	4.0	3.8	3.6	3.4

1/ Ministry of Economy definitions are used here.
2/ At current prices.
3/ At constant prices.
4/ Resource surplus/interest payments.
5/ Excluding short term principal repayments.

Source: Ministry of Economy, Central Bank and mission estimates.

Table 14

ACTUAL AND PROJECTED EXTERNAL REQUIREMENTS AND FINANCING, BASE CASE, 1981-94
(millions of US $)

	Average 1981-84	1985	1986	1987	1988	1989	1990	Average 1991-94
Exports (G&NFS)	10151	10242	8796	9940	11293	12503	13232	15497
Agricultural goods	3837	3713	2904	2777	3181	3647	4024	4710
Manufactured goods of agric. origin	2576	2454	2315	2518	2939	3341	3644	4340
Manufactured goods of industrial origin	1763	2229	1767	2441	2746	2930	2971	3494
NFS	1975	1846	1810	2204	2427	2585	2593	2953
Imports (G&NFS)	8256	5891	7025	7750	8856	9752	10100	12186
Consumer goods	543	204	278	300	326	352	379	430
Intermediate goods	3745	2600	3367	3520	4108	4523	4646	5578
Petroleum	651	400	305	400	450	450	450	532
Capital goods	1040	610	750	1030	1221	1496	1683	2298
NFS	2277	2077	2325	2500	2751	2931	2942	3348
Resource Balance	1895	4351	1771	2190	2437	2751	3132	3311
Net Factor Income	-4885	-5304	-4422	-4421	-4307	-4458	-4704	-4604
of which: interest payments	-4934	-5132	-4302	-4168	-4320	-4561	-4905	-4710
Net Private Transfers	7	0	5	5	0	0	0	0
CURRENT ACCOUNT	-2982	-953	-2646	-2226	-1870	-1707	-1572	-1293
Amortizations (total)	-4806	-4778	-2372	-2226	-1513	-2373	-2970	-4211
Change in reserves (- increase)	987	-1871	822	-833	0	-200	-250	-150
CAPITAL REQUIREMENTS	6801	7602	4196	5285	3383	4280	4792	5654
Memorandum Items								
Gross Central Bank Foreign Exchange Reserves	3510	4749	3927	4760	4760	4960	5210	5735
Current Account Balance/GDP	-4.6	-1.5	-3.8	-3.0	-2.3	-2.0	-1.7	-1.2

Source: Ministry of Economy, Central Bank and mission estimates.

Table 15

PROJECTIONS OF KEY VARIABLES, 1985-1995, HIGH CASE SCENARIO
(percentages and 1983 U.S. Dollars)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
GDP growth rate	-4.8	3.5	3.4	3.5	4.7	4.5	4.3	4.1	4.1	4.1	4.2
GDP/capita	2069	2149	2230	2315	2387	2455	2521	2582	2646	2712	2780
GNP growth rate	-4.5	8.8	5.8	6.3	4.9	4.3	4.6	4.4	4.4	4.4	4.3
GNP/capita	1894	2028	2112	2210	2282	2342	2413	2479	2548	2619	2689
US GNP deflator (1985=100)	100.0	102.6	104.7	108.3	112.1	116.0	120.1	124.3	128.6	133.1	137.8
Argentine GDP deflator (US $)	100.0	102.4	105.1	108.7	112.5	116.5	120.6	124.8	129.1	133.7	138.3
Private Investment/public investment 1/	1.3	1.1	1.0	1.1	1.3	1.5	1.5	1.5	1.5	1.5	1.6
Public Investment/GDP (%) 2/	6.1	5.3	6.6	6.9	6.6	6.5	6.8	7.1	7.4	7.7	8.0
Private Investment/GDP (%) 2/	4.5	6.6	6.8	7.7	8.7	9.5	10.1	10.8	11.3	11.9	12.4
Gross Domestic Savings/GDP (%) 3/	17.3	14.4	16.3	16.8	18.1	19.3	20.1	21.0	21.7	22.6	23.3
Exports Growth Rate 3/	8.0	-12.5	11.4	4.7	5.9	4.5	3.7	3.8	3.4	3.4	3.4
Exports/GDP (%) 2/	15.8	12.6	13.1	13.9	14.5	14.4	14.3	14.2	14.1	14.0	13.8
Imports Growth Rate 3/	-12.4	6.8	9.3	15.0	5.9	5.6	5.3	4.9	4.7	4.7	4.7
Imports/GDP (%) 2/	9.1	10.0	10.2	11.7	11.8	11.3	11.3	11.3	11.3	11.2	11.2
Exports of Goods & NFS (mill) 2/	10242	8797	9939	11511	13035	13997	14984	16032	17114	18273	19515
Imports of Goods & NFS (mill)2/	5891	7025	7750	9633	10572	10949	11836	12737	13676	14690	15767
Current Account Balance 2/	-953	-2645	-2227	-2428	-2042	-1731	-1614	-1442	-1233	-1006	-934
Total debt outstanding & disbursed (mill) 2/	48312	49073	51636	54034	56056	57778	59392	60794	61663	62280	62798
Total debt real (mill. 1985)	48312	47829	49318	49893	50005	49809	49452	48909	47949	46792	45572
Average interest charge	10.6	8.8	8.1	7.8	8.3	8.7	8.3	8.0	7.8	7.5	7.6
Debt/GDP (%) 2/	74.6	70.1	68.2	65.4	62.6	59.6	56.8	53.9	50.8	47.6	44.5
Interest Payments/GDP (%) 2/	7.9	6.1	5.5	5.1	5.2	5.2	4.7	4.3	4.0	3.6	3.4
Interest Coverage Ratio 4/	0.85	0.41	0.53	0.44	0.53	0.61	0.64	0.67	0.72	0.77	0.79
Debt Service Ratio (%) 5/	79.5	75.9	64.1	49.9	53.7	57.0	58.3	56.8	54.9	52.7	51.9
Debt/exports	4.7	5.6	5.2	4.7	4.3	4.1	4.0	3.8	3.6	3.4	3.2

1/ Ministry of Economy definitions are used here.
2/ At current prices.
3/ At constant prices.
4/ Resource surplus/interest payments.
5/ Excluding short term principal repayments.

Source: Ministry of Economy, Central Bank and mission estimates.

NON-FINANCIAL PUBLIC SECTOR ACCOUNTS - A COMPARISON OF THE BASE AND HIGH SCENARIOS
(as percentage of GDP and US dollars)

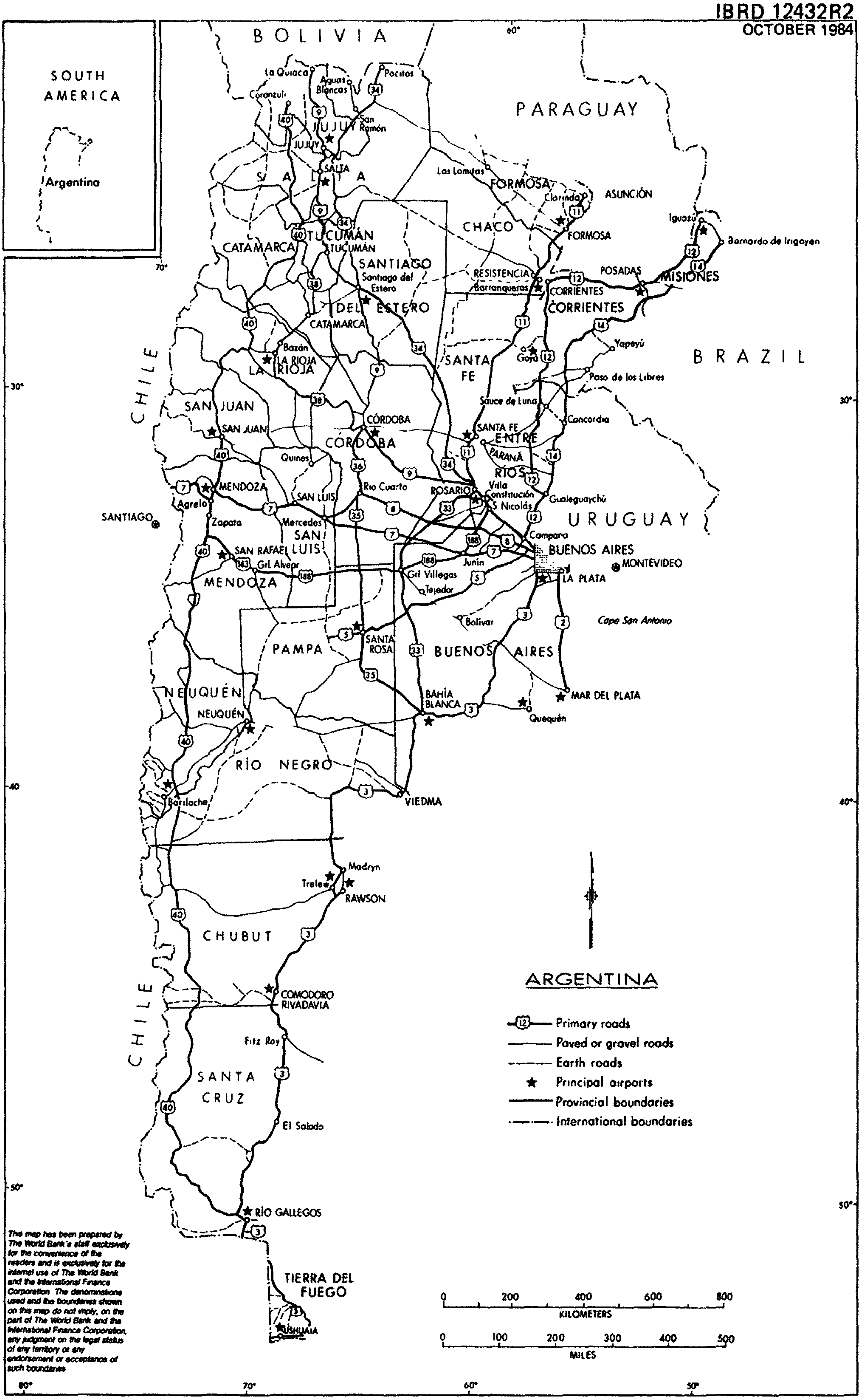
	Base Scenario							High Scenario						
	1985	1986	1987	1988	1989	1990	1995	1985	1986	1987	1988	1989	1990	1995
Revenues	27.3	26.8	27.1	27.5	27.8	27.8	27.9	27.3	26.8	27.1	27.6	27.9	27.9	27.9
Expenditures	25.4	23.6	23.3	23.0	22.8	22.6	20.9	25.4	23.6	23.2	27.6	22.4	22.2	20.3
Government Cur A/C	1.9	3.2	3.8	4.5	5.0	5.2	7.0	1.9	3.2	3.9	5.0	5.5	5.7	7.6
Capital Expenditures	6.1	5.3	5.6	5.9	6.2	6.5	8.0	6.1	5.3	6.6	6.9	6.6	6.5	8.0
Public Sector Deficit	-4.2	-2.1	-1.8	-1.4	-1.2	-1.3	-1.0	-4.2	-2.1	-2.7	-1.9	-1.1	-0.8	-0.4
Possible Financing:														
Domestic		0.5	0.5	0.5	0.5	0.5	0.5		0.5	0.5	0.5	0.5	0.5	0.5
Seignorage		0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.2	0.2	0.2	0.2	0.2
Inflation tax		3.08	2.51	1.99	1.45	0.91	0		3.08	2.51	1.99	1.45	0.91	0
External debt		-1.68	-1.41	-1.29	-0.95	-0.31	0.3		-1.68	-0.51	-0.79	-1.05	-0.81	-0.3
Memo items:														
GDP Growth rate	-4.8	5.5	4.1	3.7	3.8	3.8	3.7	-4.8	5.5	5.4	5.5	4.7	4.5	4.2
Current Account Balance	-953	-2645	-2227	-1869	-1707	-1570	-1036	-953	-2645	-2227	-2428	-2042	-1731	-934
DOD/GDP	74.6	70.1	68.9	66.3	63.6	60.9	46.4	74.6	70.1	68.2	65.4	62.6	59.6	44.5
Consumption/capita growth rate	-7.4	9.1	0.8	1.3	1.4	1.4	1.3	-7.4	9.1	0.6	3.8	2.4	2.1	1.7
Inflation rate (annual)		80	60	43	27	13	0		80	60	43	27	13	0

Note: This table follows definitions used by the Ministry of Economy.

Source: Ministry of Economy and mission estimates.

Table 16

MAP SECTION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