FOR AGENDA

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EBS/76/140
Correction 1

CONFIDENTIAL

March 19, 1976

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Use of Fund Resources - Compensatory Financing

The following correction has been made in EBS/76/140:

Page 4, Table 2, Heading: For "1974 1975 1973" read "1973 1974 1975

A corrected page is attached.

Att: (1)

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

299

EBS/76/140

CONFIDENTIAL

March 18, 1976

To: Members of the Executive Board

From: The Secretary

Subject: Argentina - Use of Fund Resources

Attached is the staff's analysis and recommendation with respect to a request expected to be received from Argentina for a purchase equivalent to SDR 110 million under paragraphs 2, 3, and 4, of the Decision on Compensatory Financing of Export Fluctuations. The decision proposed by the staff appears on page 9.

This subject will be brought to the agenda for discussion at an early date to be announced.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Argentina - Use of Fund Resources

Prepared by the Research and Western Hemisphere Departments

(In consultation with the Exchange and Trade Relations, Legal, and Treasurers' Departments)

Approved by J.J. Polak and E. W. Robichek

March 18, 1976

Introduction

The Managing Director has been informed that the Argentine authorities will shortly request a purchase of the equivalent of SDR 110 million under paragraphs 2, 3, and 4, of Executive Board Decision No. 4912-(75/207), adopted December 24, 1975. The request is being made with respect to an export shortfall for the 12-month period ended December 31, 1975. The expected purchase of SDR 110 million is equivalent to 25 per cent of quota. A waiver of the conditions of Article V, Section 3(a)(iii), of the Articles of Agreement will be required.

This paper is being circulated in advance of the formal request from Argentina in order to give the Executive Directors more time to consider the matter.

The staff appraisal and recommended decision appear in the last section of this paper. The other sections deal respectively with (1) Argentina's relations with the Fund, (2) the balance of payments position, (3) the estimation of the export shortfall, (4) circumstances responsible for the shortfall, and (5) export prospects.

1. Relations with the Fund

Argentina's position in the General Account as of March 8, 1976 is summarized in Table 1. Argentina's quota is equivalent to SDR 440 million and its outstanding purchases total the equivalent of SDR 360.1 million. The Fund's present holdings of Argentine pesos are at 156.8 per cent of quota including purchases outstanding under the compensatory financing facility and the oil facility. Repurchases in respect of the 1972 compensatory financing purchase totaling the equivalent of SDR 64 million are scheduled to be effected by December 31, 1976, which is within the five-year period.

Argentina is a participant in the Special Drawing Account and has received allocations totaling SDR 152.5 million. Holdings at March 12, 1976 were SDR 2.3 million, or 1.5 per cent of net cumulative allocation. There is a need to reconstitute in an amount of SDR 60.1 million and Argentina will be subject to designation in the quarter beginning April 1, 1976 in an amount of approximately SDR 45 million under Rule P-4.

Table 1. Argentina: General Account Position as of March 8, 1976

(Quota = SDR 440 million)

Holdings of Member's Currency	Date of Purchase	SDR Millions	Per Cent of Quota
Outstanding holdings:			
Gold tranche	June 17/18, 1975	110.00	25.00
Oil facility	November 7, 1975	40.00	9.09
	November 12, 1975	36.09	8.20
Compensatory financing	March 3, 1972	64.00	14.54
	December 23, 1975	110.00	25.00
Total holdings		690 09	156.83
(under tranche policy)		(440.00)	(100.00)
(under oil facility)		(76.09)	(17.29)
(under compensatory financing facility)		(174.00)	(39.54)
Drawing under consideration			
Compensatory financing		110.00	25.00
Grand total		800.09	181.83

Argentina accepted the obligations of Article VIII, Sections 2, 3, and 4, in May 1968. Argentina maintains a multiple exchange rate system with rates on March 8, 1976 of $a 140 per U.S. dollar (buying) in the official market for trade, financial, and trade-related invisibles, and $a 244 per U.S. dollar (buying) in the free market (tourism, other services).

The purchase expected to be requested would raise the amount outstanding under the compensatory financing decision to 64.5 per cent of Argentina's quota. As stated in paragraph 3 of the decision, requests for purchases that would increase purchases outstanding under the compensatory financing decision beyond 50 per cent of the member's quota will be met only if the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, when required, appropriate solutions for its balance of payments difficulties.

The 1974 Article VIII consultation discussions with Argentina were held in Buenos Aires during the period July 10-12, 1974 and the Staff Report (SM/74/212, 8/27/74) was discussed by the Executive Board at EBM/74/127 (10/16/74). In October 1975 an Argentine delegation visited Washington to discuss with the staff recent economic developments and prospects. Subsequently, a program to strengthen the medium-term balance of payments was presented to the Fund in connection with a request for a purchase under the 1975 oil facility (EBS/75/376, 10/20/75) involving principally a policy of realistic exchange rates and measures to strengthen public sector finances. A staff mission visited Buenos Aires in the period February 22-29, 1976 to discuss this intended purchase and also

Argentina's balance of payments policies including its progress and policies in removing restrictions in accordance with the Executive Board Decision adopted at EBM/75/170 (10/29/75). From October 1975 through February 1976, the authorities adjusted exchange rates frequently, and succeeded not only in accompanying the inflation but also in achieving an average real depreciation of the peso with respect to the U.S. dollar of more than 20 per cent. Beginning in January 1976, furthermore, the exchange rate for tourism and nontrade invisibles was permitted to fluctuate freely, and the peso in this market quickly depreciated from less than \$a 100 per U.S. dollar to about \$a 250 per U.S. dollar. Finally, on March 8, 1976 the exchange rates for all other exchange transactions were unified at the level of \$a 140 per U.S. dollar, representing an additional average depreciation of the peso for these transactions of about 30 per cent. As a result of these adjustments, the peso appears to be more realistically valued than at any time in the past several years, which should be of considerable assistance in bringing the balance of payments under control. While several of the tax increases described in the October program have been delayed, the recent large depreciation of the peso has enabled the authorities to increase substantially the duties on traditional exports, thereby providing temporary relief to the budget until the tax increases are approved by Congress.

The Argentine authorities have also reduced or eliminated a number of exchange and trade restrictions since last October. A list of 1,300 prohibited imports was allowed to expire in December; capital goods financing requirements have been liberalized somewhat by reducing grace periods and shortening the time to which the cumulative import values apply; for other imports the financing requirement was lowered to 180 days after having been temporarily increased to 240-270 days for some imports; and the system of negotiated global import quotas for 26 industrial sectors has been abandoned. The 100 per cent compulsory exchange rate guarantee deposit has also been eliminated, but a 40 per cent import deposit without a rate guarantee has been substituted.

2. Balance of payments situation

Argentina registered record balance of payments surpluses in 1973 and the first half of 1974, with net foreign assets increasing by more than SDR 1 billion during these 18 months. The balance of payments position was, however, sharply reversed in the second half of 1974, when foreign reserves fell by SDR 415 million and continued to deteriorate through mid-1975. Despite a moderation in the rate of reserve loss in the last half of 1975, the deficit for the year as a whole reached SDR 930 million (Table 2).

This reversal in the overall balance reflected an even more pronounced turnabout in the current account position, which switched from a surplus of SDR 601 million in 1973 to a deficit of SDR 1,126 million in 1975. Imports rose by almost 60 per cent in 1974, as exchange rates were held constant despite accelerating domestic inflation, but export earnings reached record levels and the current account continued to show a surplus. In 1975 the rate of import growth moderated substantially, but export earnings fell by almost 25 per cent. The factors underlying the decline in exports are described in detail below. The rate of import growth was brought down to 15 per cent in 1975 by frequent devaluations of the peso and by a tightening of controls over imports and import payments. Imports in the last half of the year were actually less than in either of the two preceding semesters.

Table 2. Argentina: Balance of Payments and Reserves, 1973-75

(In millions of SDRs)

	1973	1974	1975
Current account balance	601	183	-1,126
Capital account balance	-87	-113	196
Overall balance	514	70	-930
Gross official reserves (end of period)	1,092	1,074	385
Net official reserves (end of period)	405	475	-455

Source: Central Bank of Argentina.

The unprecedented 1975 current account deficit was financed partially by an improvement in the capital account from a net outflow in 1973 and 1974 to a net inflow of SDR 196 million in 1975. This improvement, however, resulted from growing reliance on short-term private sector borrowing, as an increase in swaps outstanding of SDR 650 million more than offset a large net outflow on account of trade credits. The Central Bank, in addition to borrowing under the Fund's compensatory financing and oil facilities, increased its foreign liabilities to banks by SDR 112 million. The decline in gross reserves was, therefore, only SDR 689 million, or SDR 241 million less than the drop in net reserves.

3. Estimation of the export shortfall

In December 1975 Argentina made a drawing under the compensatory facility equivalent to 25 per cent of quota (SDR 110 million) with respect to a shortfall year ended October 1975. Since no repurchases with respect to previous compensatory purchases were made since December 1975, Argentina's eligibility for further compensatory drawings cannot, in the absence of an emergency, exceed 25 per cent of quota at the present time. Moreover, because there is a ten-month overlap between the shortfall year associated with the December compensatory drawing and that associated with the drawing presently requested, ten twelfths of the December 1975 drawing, SDR 91.7 million, is deemed to have been in compensation for the shortfall experienced in calendar 1975. Consequently, Argentina is entitled to the maximum drawing of SDR 110 million (equivalent to 25 per cent of quota) provided the shortfall experienced in 1975 is at least SDR 201.7 million (SDR 110 million + SDR 91.7 million). This condition is satisfied if the trend is equal to at least SDR 2,690 million (SDR 2,488.3 million + SDR 201.7 million); that is to say, the average earnings in 1976-77 are not lower than SDR 2,478.5 million, which is itself slightly below the depressed level of SDR 2,488.3 million realized in the shortfall year1/

1/ Under the lower limit of the 1966 decision, the value of the 1976-77 earnings could not have been forecast below SDR 2,488.3 million.

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(Table 3). As indicated in Section 5, a recovery of export earnings is anticipated in the two post-shortfall years (1976-77). The prospective recovery in earnings following the 1975 decline ensures the existence of a shortfall as well as its temporary character.

Table 3. Argentina: Estimation of Trend and Shortfall in Exports

(In millions of SDRs)

	Calendar Years			
	1973-74 Average	1975	1976-77 Average Formula 1/	1976-77 Average Minimum 2/
Exports	3,002.4	2,488.3	4,814.5	2,478.5
Trend (five-year average centered on 1975)				
Formula		3,624.4		
Minimum		2,690.0		
Shortfall				
Formula		1,136.1		
Minimum		201.7		

Source: Central Bank of Argentina.

1/ Calculated from yearly earnings given in first row of Table 4 as:

$$\frac{2{,}736.1 + 3{,}268.6}{2} \left[\frac{2{,}736.1 + 3{,}268.6 + 2{,}488.3}{1{,}773.2 + 1{,}735.2 + 1{,}787.9} \right]$$

2/ Level required to enable the member to draw the maximum entitlement of 25 per cent of quota (SDR 110 million) after allowance of SDR 91.7 million for double compensation.

4. Circumstances responsible for the shortfall

Argentina's export earnings remained close to SDR 1.8 billion in the three years 1970 through 1972; they increased sharply in 1973 and 1974 before falling in 1975 (Table 4). The nature of the 1975 shortfall appears from the breakdown between volume and export unit values shown in Table 5 for six commodity groups, which represent two thirds of total earnings. Over the five-year period 1970 through 1974, the volume of exports does not show any clear trend; the high earnings of 1973 and 1974 are due to the sharp increase in prices during those years. In 1975 shipments fell by 28 per cent from the average level recorded in the preceding five years; simultaneously, export unit values receded from their 1974 peak.

Table 4. Argentina; Export Earnings by Commodities

(In millions of SDRs)

	Calendar Years					
	1970	1971	1972	1973	1974	1975
Total exports	1,773	1,735	1,788	2,736	3,269	2,488
Grains and related products	518	548	324	743	1,140	901
Meat and related products	429	402	623	660	363	235
Oilseeds, animal fats, and related products	140	116	70	208	223	135
Sugar	12	14	22	76	246	148
Apples and pears	46	45	45	32	71	85
Leather and related products	49	44	92	123	127	82
Wool	76	59	63	130	66	74
Metals, machinery, and other manufactures	57	70	85	192	258	153
Other exports	446	437	464	572	775	675

Source: Central Bank of Argentina.

The 1975 decline in the volume of exports was shared among all commodity groups, except wool. Meat products, however, played the major role in the shortfall (Table 5). In 1975, earnings from meat exports were SDR 276.5 million below the 1973-74 average, and much lower than at any time since 1970. The 1975 fall in meat exports was due to the virtual closing of the EEC market, a major outlet for Argentina's meat exports.

Export earnings from grains, the most important group, also contributed to the shortfall reflecting mainly adverse growing conditions which reduced yields. Rising unit values for most grains were insufficient to offset the large decline in shipments. Exports of oilseeds, animal fats and products in the shortfall year were lower on account of large declines in shipments; unit values were virtually unchanged from the average level in 1973-74. Despite substantially higher unit values for sugar and leather and leather products, earnings from these commodities fell in the shortfall year. Earnings from wool recovered in the shortfall year but remained below the average of the preceding two years. Earnings from metals, machinery, iron and steel products, and other manufactures were about 32 per cent lower than the average level in the pre-shortfall period.

The 1975 setback in Argentina's exports was partly due to the country's general economic situation with rising domestic demand, inadequate price incentives, and unfavorable exchange rate policies which acted to inhibit growth in export supplies. However, other factors noted above (unfavorable weather conditions, restrictions on meat imports and, more generally, weak demand associated with world recession) were clearly outside the control of the member. On balance, the staff considers that the shortfall was largely outside the member's control.

Table 5. Argentina: Value, Volume, and Unit Value Indices for Main Commodity Groups1/

(Index 1973-74 = 100)

Commodity	Value Share (per cent)	1970	1971	1972	1973	1974	1975
Value	100	60	58	58	95	105	77
Grains and related products	46	55	58	34	79	121	96
Meat and related products	25	84	78	122	129	71	46
Oilseeds and related products	10	65	54	32	97	103	63
Sugar	8	7	9	14	47	153	92
Leather and related products	6	39	35	74	98	102	66
Wool	5	78	60	64	133	67	76
Volume		119	97	91	109	91	73
Grains and related products		98	91	57	97	103	77
Meat and related products		175	114	165	133	67	64
Oilseeds and related products		112	96	60	111	89	62
Sugar		20	22	27	88	112	59
Leather and related products		117	90	128	104	96	50
Wool		212	195	170	131	69	155
Unit Value		50	59	60	86	114	105
Grains and related products		56	63	61	82	118	126
Meat and related products		50	70	73	96	104	70
Oilseeds and related products		48	49	45	86	114	101
Sugar		39	44	52	56	144	163
Leather and related products		34	39	58	94	106	132
Wool		37	31	38	101	99	49

Sources: Central Bank of Argentina; and Fund staff calculations.

1/ The individual commodities listed accounted for 68 per cent of total exports in 1973-74.

5. Export prospects

Argentina's export earnings are expected to be higher in the two post-shortfall years (1976-77) than in the shortfall year (1975). The recovery is likely to result mainly from an anticipated increase in the volume of exports Despite the prolonged dry weather in November-December 1975, production of wheat and sorghum should be higher in 1975/76 than in the previous season. Moreover, export availabilities are expected to increase for most other commodities, particularly meat and related products.

With the exception of sugar and oilseeds, export unit values for most of Argentina's commodities are expected to be slightly higher in 1976-77 than in the shortfall year. Combining the anticipated increase in the volume of exports with some gain in average unit values, Argentina's export earnings should exceed the 1975 level and, therefore, the minimum level of SDR 2,478.5 million required for a compensable shortfall of SDR 110 million.

6. Staff appraisal and proposed decision

Argentina registered an overall balance of payments deficit of SDR 930 million in 1975. At the end of 1975, gross official reserves were SDR 385 million, while net official reserves were negative by SDR 455 million. The shortfall in exports, based on the formula of paragraph 6 of the compensatory decision, is substantially in excess of the maximum entitlement of Argentina (25 per cent of quota, equivalent to SDR 110 million). The minimum projected value for exports in 1976-77 (SDR 2,478.5 million), which is consistent with the maximum entitlement, is slightly below actual exports in 1975 and is not considered unreasonably high. Under the gold tranche, and under the compensatory financing and oil facilities, Argentina has drawn SDR 296 million in 1975. Consequently, the requested compensatory drawing of SDR 110 million does not give rise to overcompensation.

The shortfall was largely attributable to a sharp decline in meat exports, Argentina's second most important export product, reflecting partly restricted access to major meat markets, and partly lower unit values and/or lower shipments of most agricultural commodities.

The drawing expected to be requested would raise the amounts outstanding under the compensatory facility to 64.5 per cent of quota. The nature and extent of Argentina's cooperation with the Fund in finding appropriate solutions to its balance of payments problems have been discussed in Section 1. In this connection, the staff finds that, overall, there has been a substantial reduction in the restrictiveness of the trade and payments system of Argentina since its letter dated October 8, 1975 and that progress has been made in simplifying the exchange system. The letter was submitted to the Fund for the purpose of a purchase under the oil facility for 1975 (EBS/75/376).

In the staff's opinion, Argentina has been cooperating with the Fund in satisfaction of the requirement set forth in paragraph 3(ii) of the compensatory financing decision. The request presently contemplated by Argentina is expected to include a statement that Argentina will continue to cooperate with the Fund to find appropriate solutions for its balance of payments difficulties. The request will also include the representation with respect to repurchases required by paragraph 7 of Executive Board Decision No. 4912-(75/207), adopted December 24, 1975.

The staff believes that the expected request from Argentina for the purchase of the equivalent of SDR 110 million under the compensatory financing decision will meet all the requirements set forth in that decision. Accordingly, the following decision is recommended for consideration of the Executive Directors and adoption after a duly authenticated request has been received.

The Fund has received a request by the Government of Argentina for the purchase of the equivalent of SDR 110 million under paragraphs 2, 3, and 4, of the Compensatory Financing of Export Fluctuations Decision (Executive Board Decision No. 4912-(75/207), adopted December 24, 1975). The Fund agrees to the requested purchase and grants the necessary waiver of the conditions of Article V, Section 3(a)(iii), of the Articles of Agreement on the repurchase terms set forth in the cable to the Fund dated . . . .