Argentina—Letter of Intent, Memorandum of Economic Policies, Technical Memorandum of Understanding

Buenos Aires, August 30, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Köhler,

1. The economic policy framework of the government of Argentina for the period 2000-02, in support of which we requested a three-year Stand-By Arrangement from the Fund, was outlined in our memorandum of economic policies dated February 14, 2000. These policies center on fiscal consolidation and wide-ranging structural reforms aimed at promoting a sustained recovery of output and employment, with price stability and a continuing improvement in the external accounts.

2. Substantial progress has been made in the implementation of these policies, as described in the policy memoranda accompanying the previous reviews under this program. Nevertheless, adverse domestic and external developments have continued to impede a sustained recovery of confidence and have led to a sharp tightening of financing constraints for both public and private Argentine borrowers, making it more difficult to restart growth and affecting adversely the fiscal performance. Confronted in early July with a sharp worsening of financing conditions, the government decided to move boldly to correct the fiscal imbalance and set the public finances on a sustainable path. To this end, it proposed, and obtained legislative approval for, a zero-deficit law designed to maintain fiscal equilibrium from July onwards. Firm and continued implementation of this law, to which the government, as well as the provincial governments, is fully committed, will result in a major strengthening of the fiscal adjustment, and therefore in the attainment of fiscal balance and a sustainable public debt position much earlier than anticipated in our original program. On the basis of this new program, and to strengthen market confidence in the appropriateness of this policy response, and its prospects of success, we are requesting an increase in the amount made available by the IMF under the Stand-By Arrangement, from SDR 10,586 million to SDR 16,937 million (800 percent of Argentina's quota), of which SDR 6,087 million (288 percent of quota) would be provided under the Supplemental Reserve Facility (SRF).

3. We trust that the determined implementation of the government's strengthened economic strategy, in conjunction with this enhanced financial support package, will bolster market confidence in Argentina, facilitating a progressive return of borrowing costs to more normal levels, and a sustained recovery of domestic activity and investment. We will

maintain a close policy dialogue with the Fund, and take any further steps that may be needed to promote the achievement of the government's economic policy objectives, in the light of evolving circumstances. Reviews of the program will be carried out before December 15, 2001 and March 15, 2002.

Sincerely yours,

/s/	/s/
Roque Maccarone President Central Bank of the Republic of Argentina	Domingo Cavallo Minister of Economy

Memorandum of Economic Policies

I. Background

1. Despite a difficult environment, the government implemented decisively the measures agreed under the program and the quantitative targets for end-June were met, some with large margins. However, financial market sentiment about Argentina took a negative turn in July: spreads on Argentine bonds reached peak levels, bank deposits and international reserves declined, interest rates rose sharply, and the government lost access to the credit markets. The government responded quickly to this deterioration with measures aimed at eliminating the fiscal deficit and speeding up structural reform. This memorandum of economic policies (MEP) describes recent developments and the policies adopted by the government to strengthen the program.

II. Recent Developments

2. In recent months, the government has moved to address a series of adverse developments:

- **Economic activity continues to be weak**. Real GDP declined by 2.1 percent (year-on-year) in the first quarter of 2001, after falling by ½ percent in 2000. However, indicators of economic activity, such as industrial production and construction activity showed modest increases in the second quarter. Despite the creation of 275.000 jobs relative to the previous year, the unemployment rate rose to 16 percent in May from 15 percent a year earlier. Consumer prices fell further in July 2001 to 1.1 percent below their level a year earlier, while wholesale prices fell by 1.8 percent.

- **Financial market indicators deteriorated sharply** in recent months, with spreads on Argentine bonds widening to over 1,700 basis points in July, before narrowing subsequently; domestic interest rates increased; and international agencies downgraded Argentina's debt further in the same month.

- **Despite the weak economy, the fiscal targets of the program for June were met with comfortable margins.** Tax revenue was Arg$160 million lower than programmed, reflecting also the deterioration in financing conditions, and continued difficulties with tax compliance. In response, the government introduced additional expenditure cuts and the deficit and primary expenditure targets of the program for end-June were met with a margin of Arg$130 million and Arg$227 million, respectively. The provinces also met the fiscal target for June with some margin. The deterioration in tax revenues quickened in July as financial conditions worsened; tax revenues were lower by 8.7 percent (year-on-year) and the fiscal deficit for the month reached about Arg$1.2 billion on a cash basis.

- **The banking system came under pressure**. Although external credit lines and banks'nonperforming loans have remained relatively stable in recent months, liquidity has been under pressure from a drain on private sector deposits after many years of sustained growth. These deposits fell by Arg$6.6 billion in the first semester of the year and declined further by Arg$5.4 billion in July. Banks have responded in part by cutting credit to the private sector (down 8 percent in the first seven months of 2001) and seeking liquidity assistance from the central bank.

- **The external trade surplus has strengthened,** as a result of a marked drop in imports and a solid performance of exports. The trade surplus in the first half of 2001 was US$2 billion, 130 percent higher than that for the same period last year.

3. A number of significant policy measures have been introduced in recent months:

- **The new convertibility law was approved by congress** in June linking the peso to an equally weighted euro-US$ basket when the two currencies reach parity. The new mechanism preserves all the features of the previous regime, but allows for a more stable nominal effective exchange rate.

- **A compensation mechanism for foreign trade in nonenergy goods was introduced** designed to improve competitiveness and rationalize trade policy. The mechanism, which is administered through the federal government's budget, provides exporters with a reimbursement, and charges importers a duty, equivalent to the difference between the present exchange rate and that on a corresponding equally weighted euro-US$ basket (about 5 percent at mid-August); the mechanism also reduces the dispersion of import tariffs and export rebates. The maximum import tariff for non-Mercosur trade was reduced by 7 percentage points (to 28 percent) to ensure that the tax scheme did not breach the WTO binding tariff. The compensation mechanism will disappear as the euro reaches parity with the U.S. dollar, which will result in a lower average level of import tariffs than was the case prior to its introduction.

- **A series of competitiveness plans were launched** aimed at improving profitability in the sectors most affected by the recession. Common elements to all the plans include the exemption from the tax on interest paid and from the minimum corporate income tax, and allowing employer's social security contributions to be credited against VAT payments. The sectorial implementation of these plans allows to trigger deregulation and tax reductions at the provincial level as well as enhanced labor flexibility, without granting benefits beyond those that will be present in the simplified tax structure to which the system is expected to converge.

- **A fiscal package was introduced in June** aimed at strengthening the public finances and promoting private consumption; it included: (i) an increase in personal and family income tax deductions and in the tax-free allowance for luncheon vouchers; (ii) the unification of employer social security contributions at 16 percent (employers that experienced an increase in the payroll tax as a result could offset the increase against VAT liabilities); (iii) an increase in taxes on diesel fuel, allowing the original level to be credited against the VAT, and a reduction in gasoline taxes (to be effective in 2002); (iv) plans to move the VAT from an accrual to a cash basis; and (v) a reduction in the VAT rate to be applied to agriculture (to a rate still to be decided) and (vi) a further broadening of the coverage of the VAT (transportation, cable T.V., printed press, and others).

- **An exchange of debt** was completed in June involving bonds with a face value of US$29.5 billion; the exchange reduced contractual debt service obligations in 2001-05 by about US$12 billion by shifting principal payments beyond this period, capitalizing interest, and using step-up coupons. The debt exchange raised average duration by close to three years.

- **To ease banks' liquidity difficulties** stemming from the deposit drain, in July the central bank cut liquidity requirements on time deposits by 1 percentage point (to 21 percent), injecting about Arg$1 billion into the system; in addition, banks were permitted to use the "float" to meet the liquidity requirements, and up to 70 percent of liquidity requirements on time deposits could be met with peso balances, rather than U.S. dollar balances.

III. The Government's Revised Program for 2001

4. **The macroeconomic framework for 2001** was revised in light of the performance in the first half of the year (Box 1). Real GDP growth is conservatively projected to be: negative for the year as a whole driven by weak consumption and investment. The deflation of consumer prices would continue for the third consecutive year. The external current account deficit would narrow markedly, mainly reflecting a sharp improvement in the trade balance. With economic activity declining, imports (f.o.b.) are projected to fall by 7 percent (in U.S. dollar terms), whereas exports would broadly maintain the 4 percent rate of growth recorded in the first half of the year (6 percent in real terms, despite negative shocks affecting meat, soybean, and fish exports). Our program would be consistent with some recovery of central bank international reserves in the final months of the year, although by year-end they are projected to be about US$4.5 billion down from end-2000.

Box 1. Revised Macroeconomic Scenario, 2001

	Revised	**Original**
	(Annual percentage change)	
Real GDP	-1.4	2.0
GDP deflator	-0.3	0.2
	(In billions of U.S. dollars)	
External current account balance	-8.1	-10.0
In percent of GDP	-2.9	-3.4
External trade balance	3.1	2.0
***Memorandum item*:**		
Gross international reserves at the central bank, US$ billions	22.5	25.9

5. On unchanged policies, the revised macroeconomic scenario, the deterioration of financing conditions, tax reductions associated with the competitiveness plans, and delays in the sale of third generation telecommunications frequencies were projected to reduce programmed fiscal revenues by about Arg$3.2 billion (about 1 percent of annual GDP) in the second half of 2001. The resulting fiscal deficit would have exceeded the targets specified in the fiscal responsibility law and under the Fund program and--in the current circumstance of lack of access to financial markets--would not have been possible to finance.

6. Confronted with this situation, and to establish a definitive solution to the fiscal problem, on July 11 the government announced a new economic package seeking a **major strengthening of the fiscal effort** centered on the rapid elimination of the federal government deficit, much earlier than envisaged in the Fund supported economic program. Legislation was sent to congress that would require the federal government to limit expenditures to the available revenue; congress approved this **zero-deficit law** at the end of July. The law mandates the Secretary of the Treasury to introduce across-the-board proportional cuts in primary expenditures (including wages, pensions, and purchases of goods and services) to ensure that the federal government budget is balanced on a cash basis, initially for the period August-December 2001.

7. To comply with this law, we are implementing a number of measures. **On the revenue side**, the financial transactions tax, which can be partially credited against the VAT and income tax, was increased to 0.6 percent, and exemptions from the tax were reduced. Payroll taxes on firms in the services sector were raised by 4 percentage points. In addition, the government has delayed the planned reduction in income and gasoline taxes, and the shift in the VAT from an accrual to a cash basis.

8. As part of the program, the government will continue to make steady **progress in tax administration**. In this area, specialized tax tribunals to deal with tax evasion cases that exceed Arg$1 million are being established and are expected to be fully operational by the turn of the year. In addition, the internal revenue agency (AFIP) has completed the national tax audit plan and is strengthening the independence of the auditing units; about 40 percent of the 100,000 audits of taxpayers envisaged in the program have been completed, and the authorities are confident that all the audits will be completed on schedule by the sixth review of the program. The enforcement of tax collections is to be strengthened through: (i) cross-checking the information obtained from the financial transactions tax with tax returns submitted by individual taxpayers, which is expected to increase tax compliance; (ii) prosecuting banks that do not cooperate with tax administration efforts to seize funds held in bank accounts of taxpayers who refuse to pay their tax debts; (iii) recovering tax debts by executing levies on debtors of delinquent taxpayers; and (iv) establishing cooperative arrangements with provincial governments to facilitate access by federal tax officials to information in provincial property and vehicle registers in order to secure payment of outstanding debts. VAT compliance will be increased by launching an intensive program of audits focusing on excess credit entitlements and of inspection visits to control compliance with basic VAT bookkeeping and invoice requirements. Also, a special audit program, including issue-oriented and comprehensive audits, will be conducted on the country's 2,500 largest taxpayers.

9. Achieving the fiscal target also will depend critically on efforts **on the expenditure side**. Consistent with revenue projections (Box 2), the government will cut primary expenditure by about Arg$2.3 billion in the second half of the year. To achieve this, the government is taking a number of measures: (i) a Arg$1.3 billion reduction in primary expenditure, which went into effect in July, that included a 13 percent cut in wages and pensions above Arg$500 a month and a 30 percent cut in the contractual wage bill; (ii) additional savings in the area of the social security system (arising from measures described in paragraph 13 below) of Arg$170 million. In the event that tax revenue for the remainder of the year continues to fall short of the levels included in the 2001 budget, as was already the case in July, and therefore, the federal government cannot allocate resources for the additional transfers required to comply with the tax sharing floor set in the Federal Fiscal Pact of December 2000, we will seek to rebalance the terms agreed in the pact, to yield net savings of up to Arg$900 million over the remainder of 2001. Additional measures will be implemented if needed to comply with the zero-deficit law.

Box 2. Federal Government: Revision to 2001 Deficit Projection

(In Argentine peso billions)

	First Semester	Second Semester	Year
Revenue shortfall (-)	-0.2	-3.2	-3.3
Primary expenditure cuts (-)	-0.2	-2.3	-2.5
Changes in net interest payments	0.5	-1.3	-0.8
Net effect of adjusters (see TMU - EBS/01/66)	-0.5	0.5	0.0

10. The spending cuts that are being implemented are projected to reduce primary spending to well below the program targets for the remainder of 2001, which will permit a tightening of the expenditure ceiling for end-September and end-December. The revised target will need to be indicative because in case of a better than programmed performance of tax revenue the government is required by the zero-deficit law to reverse some of the cuts in wages and pensions (as long as the fiscal balance is maintained). The adjustment measures being put in place will ensure the observance of the program fiscal target for end-December 2001 (a deficit not to exceed Arg$6.5 billion on a cash basis). However, given the sharp drop in revenue occurring in the third quarter of the year, the ceiling on the deficit for end-September will need to be raised by Arg$350million to Arg$6.6 billion.

11. **The provincial governments** are supporting the adjustment effort of the federal government by implementing a number of measures to eliminate their fiscal deficits. These measures include the elimination of some exemptions from provincial taxes, wage reductions, incentives for early retirement, and administrative reforms. Provinces are implementing significant reforms in the political sphere which will result in important savings in the operating expenditures of provincial legislatures and municipal councils. As in the case of the federal government, these steps are expected to ensure achievement of the program targets for the provincial deficit in the remainder of the year. To deal with the deterioration of financing conditions, provincial governments will continue privatization actions, including sanitation and energy companies and provincial lotteries; and, within the limits specified in their own legislation, will pay part of the wage bill and debt to suppliers with provincial bonds. The federal government will assist in this regard by allowing these bonds to be used in the payment of federal taxes, up to a fixed amount equivalent to the provincial wage bill of one month. These payments, accounted separately for each province, will be deducted from the federal tax revenue shared with each province. In May 2001 the government published and posted on the internet the first report on the implementation of the federal fiscal pact, explaining the actions taken by provincial governments to improve their legislation and to increase transparency in their operations, and indicating their progress in containing primary spending and reducing deficits; the second quarterly report was published in August 2001.

12. Achieving fiscal balance in 2002 will require substantial additional adjustment effort. Fiscal revenue next year is projected to remain at about the same level as 2001, with gains resulting from higher economic activity and improved tax administration compensating for the loss of one-off revenues received this year, and the full year impact of growth enhancing measures introduced during the last ten months. Primary expenditure will be reduced by about Arg$6 billion (2 percent of GDP) compared to the projected outturn for 2001,to be achieved through the application of the instruments provided by the zero deficit law and further progress in improving tax administration, public sector reform, and savings in the social security administration. We are confident that the spending reductions being implemented, together with those planned for next year, will put the public finances on a sustainable path much more quickly than envisaged previously under the program. The

government expects to achieve fiscal balance in 2002, excluding the capitalization of interest arising from the 2001 debt exchange.

13. Notwithstanding the current difficult financial conditions, the government is confident of securing a voluntary rollover of obligations maturing during the remaining months of 2001. The **gross borrowing requirement of the nonfinancial public sector** for the period August-December 2001 is estimated to be Arg$9.2 billion, of which Arg$4.3 billion reflects the roll over of short-term treasury bills. The financial program is covered through scheduled disbursements from official sources, understandings reached with local banks and pension funds to refinance maturing treasury bills as well as some short-term placements with local institutional investors. We expect that firm implementation of the fiscal measures, and the prospect of early elimination of the fiscal deficit, to result in a major improvement in market confidence, allowing the government to re-enter international bond markets in 2002.

14. **Private sector involvement** in financing the fiscal program in 2001 is expected to reach about US$15 billion, comprising the bond placements in international and domestic markets noted above, and amortization savings resulting from the June debt exchange of US$3.7 billion. In addition, we expect to utilize the contingent repo facility with international banks of about US$1.2 billion. We are also considering launching another debt exchange operation in the coming months. To facilitate any such exchange, we may request an acceleration of up to US$3 billion of the proposed augmentation of the program.

15. The government has introduced a facility that will allow the collateralization of interest coupons on bonded debt. This facility will receive sovereign bonds from current holders and it will issue: (i) a sequence of prepaid tax receipts in exchange for the interest coupons and (ii) a claim for the principal. The holders of the prepaid tax receipts will be allowed to use them to pay their taxes at the time the coupons mature. At current depressed bond price levels, this scheme will allow tax payers to reduce future tax liabilities, while strengthening the guarantees on government debt, without affecting the budget balance.

16. The strong **liquidity and capitalization defenses of the banking system** established in recent years have been vital in helping banks weather the recent financial turbulence. To ensure the integrity of these defenses, as deposits recover during the remainder of 2001, the government intends to return the liquidity requirement ratio to 22 percent. Reflecting these developments, the NDA ceiling under the program has been modified. Scheduled disbursements from the Fund in the remainder of 2001 (taking into account the proposed augmentation) amount to about US$7.4 billion and will contribute to a strengthening of international reserves of at least US$4 billion. In the future, liquidity assistance by the central bank will be provided through selective discount and repo operations at interest rates that preclude arbitrage opportunities. Banks with persistent liquidity problems will be given liquidity support provided they agree with the central bank on measures to strengthen their balance sheet. In addition, during the remainder of 2001, the central bank will not authorize banks to increase the amount of bonds held as part of their current level of liquidity reserves.

17. Steps have been taken to **strengthen the public banks**. As part of its recapitalization plan, in July the Banco Provincia (BPBA) exchanged with the province of Buenos Aires (PBA) its nonperforming loans for a provincial bond. The bank also began to provision its exposure to the PBA, and changes were made to the statutes governing the bank to limit loan exposure to individual clients and provide for the prosecution of negligent managers. Additional measures to strengthen the public banks are: (i) to accelerate the schedule for full compliance of BPBA with prudential regulations to no more than two years; (ii) to ensure that they comply in a timely manner with the reporting requirements of the central bank; (iii) to request the commissioning, before the end of the year, of an independent

external audit of BPBA to assess the economic and financial condition of the bank; and (iv) with respect to Banco Nación and the other public entities, the central bank will adopt the measures required to attain similar objectives of transparency and efficiency, with due regard to the particular circumstances of each entity.

18. In order to provide a stronger and more sustainable basis for the finances of the overall public sector over the medium term, the government will seek to **reform the revenue sharing arrangement** between the federal government and the provinces to: (i) simplify the system, including by reducing revenue earmarking; (ii) make it more transparent; (iii) make transfers less cyclical and consistent with macroeconomic constraints; and (iv) allow for a better match of each province's share with its own revenue effort. Constitutionally, unanimous agreement of all the provinces on the draft legislation will be needed. The government intends to reach such agreement on or about November 30, 2001, with a view to submitting the proposed legislation to the congress in December.

19. The hard budget constraint imposed by the zero-deficit law generates strong incentives within the Public Administration to accelerate the pace of reform. Since the approval of this law, the **reform of the public administration has progressed** significantly in several areas: the executive boards of many decentralized agencies have been reduced to just three executive directors, and seven public entities have been merged or closed to eliminate waste and redundant entities; public procurement policies have been strengthened by the introduction of an electronic purchasing system for public goods and services, which is expected to generate eventual savings of 10-15 percent on total purchases (Arg$200-300 million a year); and program managers are being made more accountable by establishing a direct link between the financing of their programs and the results obtained. A 30 percent reduction in total contractual-workers' compensation has been introduced. Other actions include a new law aimed at strengthening the operations of regulatory agencies, steps to streamline a number of ministries, and new regulations tightening the conditions governing public sector employment.

20. **The social security administration (ANSES) has been strengthened** to reduce the abuse of family allowances and other programs: the mechanism of compensated allowances (whereby small firms are allowed to pay to ANSES their contributions on a pre-set basis) has been discontinued; spousal benefits have been consolidated to avoid duplication of benefits for dependents; a minimum contributing wage of Arg$100 a month has been established. The first two measures are yielding savings of some Arg$6.5 million a month; and public employees are no longer allowed to draw a pension and at the same time remain employed by the federal government. Also, its newly appointed management is taking steps to: (i) limit operational expenditures of ANSES to no more than Arg$150 million per year (already there has been a streamlining of management and staff positions and a sharp reduction of contractual personnel); (ii) to eliminate abuses in former provincial pension funds which were transferred to the federal government by auditing beneficiaries receiving pensions exceeding Arg$500 per month, and (iii) strengthening controls to reduce evasion at the level of social security contributions.

21. In the area of labor **market reform**, the ministry of labor has initiated the renegotiation of expired labor contracts, which is expected to result in greater flexibility in employment practices. In addition, plans are being developed to increase the labor market skills of new job seekers and the unemployed by allowing employers to offer them temporary employment contracts at a reduced wage and benefit level.

22. Mercosur has been reaffirmed as the mechanism for trade integration. During the recent Asuncion summit, the presidents of the Mercosur countries agreed to speed up trade negotiations with other interested partners, including the FTAA Initiative. The agreement included the creation of a Mercosur trade-negotiating unit to accelerate integration with

major trading partners and the establishment of a high-level commission to review the common external tariff. It was also agreed to speed up the resolution of a number of controversies, in particular those surrounding the auto-sector. It is the intention of the Argentine authorities to strengthen Mercosur and to promote further initiatives aiming at increased macroeconomic coordination in the region.

Technical Memorandum of Understanding

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria for the economic program described in the Memorandum of Economic Policies.

1. **Cumulative balance of the Federal Government**.

Cumulative balance of the Federal Government	Limit (floor, in millions of Arg$)
End-September 2001 (performance criterion)	-6,601
End-December 2001 (performance criterion)	-6,500
End-December 2002 (indicative)	-2,290

The balance of the Federal Government comprises the results of the Federal Government and of the central bank (BCRA). The result of the Federal Government will cover government activities as specified in the 2001 budget, and will include: the balances of PAMI, the Fondo Fiduciario de Infraestructura, and the cash-flow balance of trust funds established for the administration of federal tax debts and credits; the issue of bonds in exchange for *Plan Canje* tax certificates, and in settlement of any other overdue government obligations; and exclude transfers from the central bank, privatization receipts, and capital gains realized on the sale of financial assets. The result of the Federal Government will be measured from below the line on the basis of: (a) the information provided by the public sector debt reporting system (SIGADE), including all short-term debt of the Federal Government and, in 2001, excluding the capitalized interest in the amounts detailed in adjustor 4.o below; (b) net asset transactions of the Federal Government as reported by the *Secretaría de Hacienda*, the *Dirección Nacional de Cuentas Internacionales* (DNCI) and the *Gerencia de Manejo de Reservas Internacionales* of the BCRA; and (c) information on bank borrowing and bank deposits provided by the BCRA. The result of the BCRA is defined as interest earnings on gross international reserves (as defined below) plus interest on government bond holdings of the BCRA minus net interest paid on reverse repos. Starting in 2002, interest capitalization on government bonds will be counted as expenditure. The limits on the balance of the Federal Government will be subject to the following adjustors:

a. The limits will be adjusted downward (i.e., the deficit will be allowed to rise) by up to Arg$2.1 billion for the settlement in 2001 of contested obligations incurred before December 10, 1999 as specified in the Economic Emergency Law of December 1999 and described in 4.e below (excluding overdue FONAVI transfers); this amount would include up to Arg$210 million for the issue of bonds in exchange for *Plan Canje* tax certificates.

b. The limits will be adjusted downward (i.e., the deficit will be allowed to rise) by the early payment of accrued interest on bonds surrendered in bond exchanges, and upward by the extinction of the obligation to continue to pay interest on the same bonds after the exchange. Should the bonds issued in exchange for the bonds rescued carry coupons due at some point in 2001, those coupons should be netted out of the upward adjustor just mentioned;

c. The end-September 2001 limits will be adjusted upward by the value of the nontax revenue from the sale of collateral released through the rescue of Brady bonds effected through those dates;

d. d. The end-December 2001 limit will be adjusted downward by 50 percent of the shortfall in revenue from the concession of telecommunication frequencies relative to the amount envisaged in the program (US$800 million).

2. **Cumulative ceiling on primary expenditure of the Federal Government**.

Cumulative primary expenditures of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-September 2001 (indicative)	39,194
End-December 2001 (indicative)	50,684

This ceiling applies to the noninterest expenditure of the Federal Government (including the deficit of PAMI) as defined in 1 above and reported by the *Secretaría de Hacienda*. The limits on the primary expenditure of the Federal Government will be adjusted: upwards by the equivalent of the adjustments included in 1.a above.

3. **Cumulative balance of the provincial governments**.

Cumulative provincial government balance	Limit (floor, in millions of Arg$)
End-September 2001 (indicative)	-2,080
End-December 2001 (indicative)	-2,760
End-December 2002 (indicative)	-2,000

The balance of the provincial governments comprises the consolidated result of the provinces, including the city of Buenos Aires. The result of these jurisdictions will be measured from above the line, with expenditure defined on an accrual basis and including all spending that provincial governments may decide to pay with bonds (such as salaries paid with Patacones) and all interest on bonds issued by the province of Buenos Aires to recapitalize *Banco Provincia (BPBA)*, according to the information provided by the *Secretaría de Hacienda*. These limits will be indicative.

4. **Cumulative change in the debt of the Federal Government**.

Cumulative change in the debt of the Fed. Gov.	Limit (ceiling, in millions of Arg$)
End-September 2001 (performance criterion)	6,751
End-December 2001 (performance criterion)	6,700
End-December 2002 (indicative)	2,290

The change in the debt of the government will be defined as the difference between the stock of debt at each relevant date in 2001, valued at end-2000 exchange rates and measured at end of period, and the stock of debt at end-2000. The debt of the Federal Government includes all foreign currency denominated and Argentine peso denominated debt obligations and guarantees, as defined in EBS/00/128 (June 30, 2000) and Executive Board Decision adopted August 24, 2000 and incorporated herein by reference, of the Federal Government (including public enterprises, PAMI, INDER, and trust funds, such as, but not limited to, any trust fund that may be established to administer federal tax debts and credits). These debt obligations include those with local and foreign financial institutions, international organizations, bonds and bridge loans. The data used to monitor debt developments will be taken from SIGADE, including all short-term Federal Government debt. The limit on the change in federal government debt will be adjusted in the following ways:

a. Upward (downward) by the increase (decline) in the deposits of the Federal Government in the central bank, the domestic banking system and abroad, adjusted for any over compliance in the cumulative balance of the Federal Government performance criterion as defined in 1 above;

b. Upward (downward) for the net increase (decrease) in the valuation of net debt operations--including both placements and amortizations--made after December 31, 2000 in currencies other than the U.S. dollar arising from the difference between actual exchange rates and those of end-December 2000. To ensure the timely calculation of this adjustor, the authorities will provide the Fund with information on all debt operations (placements and amortizations) on a weekly basis indicating the currencies and exchange rates at which the operations were carried out.

c. Downward for any privatization proceeds;

d. By the difference between the result of the central bank in 2001 as defined in 1 above and the transfers effectively made by the central bank to the Federal Government;

e. Upward, by up to Arg$2.1 billion, for debt issued in 2001 for the consolidation of past obligations (including bonds issued in exchange for *Plan Canje* tax certificates, for the capitalization of interest on previously issued consolidation bonds, and for settling past obligations recognized in Decree 799/2001--excluding FONAVI--), by up to Arg$800 million for consolidation of past obligations of INDER, and by up to Arg$400 million for payments due to judicial rulings relating to past claims on the Social Security Administration (ANSES);

f. Downward (upward) by the reductions (increases) in nominal debt arising from debt cancellations or swaps in 2001;

g. Downward for an amount equivalent to the difference between the proceeds from the sale of collateral released through the rescue of Brady bonds in 2001 and the nontax revenue obtained as a result of these operations;

h. Upward for debt issued in 2001 to finance the Fiscal Stabilization fund by up to Arg$450 million in 2001;

i. Upward, by up to Arg$1,850 million, for amounts relating to borrowing in 2001 by the Provincial Development Trust Fund for the restructuring of provincial debt;

j. Upward, by up to US$1.5 billion, for borrowing in 2001 from multilateral agencies on behalf of provinces, municipalities, and official banks (*deuda indirecta*) in 2001;

k. Upward by the early payment of accrued interest on bonds surrendered in bond exchanges, and downward by the extinction of the obligation to continue to pay interest on the same bonds after the exchanges. Should the bonds issued in exchange for the bonds rescued carry coupons due at some point in 2001, those coupons should be netted out of the downward adjustor mentioned in the last sentence;

l. The limits for end-September 2001, downward by the value of the nontax revenue from the sale of collateral released through the rescue of Brady bonds effected through those dates;

m. The end-December 2001 limit will be adjusted upward by 50 percent of the shortfall in revenue from the concession of telecommunication frequencies relative to the amount envisioned in the program (US$800 million).

n. Upward (downward) by the issue (redemption) of securities recognizing tax credits issued by any trust fund established to administer federal tax debts and credits;

o. The limits for end-September and end-December 2001, upward by up to Arg$36 million and Arg$1,061 million, respectively, for interest capitalized on the promissory note 2003 and Global bonds 2018 and 2031 (all issued in the June 2001 debt swap).

5. **Cumulative change in short term debt of the Federal Government**.

Cumulative change in federal short term debt	Limit (ceiling, in millions of Arg$)
End-September 2001 (performance criterion)	3,500
End-December 2001 (performance criterion)	3,500

The short term of the Federal Government consists of all domestic and foreign federal and federally guaranteed debt with an original maturity of one year or less.

6. **Cumulative change in the debt of the Consolidated Public Sector (CPS)**.

Cumulative change in debt of the CPS	Limit (ceiling, in millions of Arg$)
End-September 2001 (performance criterion)	8,876
End-December 2001 (performance criterion)	9,460
End-December 2002 (indicative)	4,290

The change in the debt of the consolidated public sector includes the sum of the changes in the debt of the Federal Government as defined in 4 above (including all the corresponding adjustments) and that of the provincial governments and the city of Buenos Aires, net of changes in intergovernmental debt (including debt to the Provincial development Trust Fund arising from debt restructuring operations). The debt of the provincial governments and the city of Buenos Aires will be defined to include obligations to local and foreign financial institutions (as reported by the *Secretaría de Hacienda* with respect to the end March, 2001 performance criterion, and subsequently by the central bank), to international organizations, and bonds (including bonds issued to settle commitments made in the current fiscal year, such as, but not limited to, Patacones issued in partial payment of salaries, but excluding other peso denominated bonds placed outside the financial system). The limit in this provincial debt will be adjusted: (a) downward for any privatization receipts; (b) downward for capital gains realized in the sale of financial assets; (c) upward by the nominal value of the bond issued by the province of Buenos Aires to clean up bad loans from the balance sheet of Banco Provincia (BPBA), net of the book value of any loans that, having become nonperforming after March 31, 2001, may be acquired by the provincial government as part of this operation; and (d) upward (downward) for any increase (decrease) in net deposits of the provinces in the banking system during the year. The data used to monitor the provincial debt will be provided by the *Secretaría de Hacienda*, the SIGADE, and the central bank. The stock of debt will be valued at end-2000 exchange rates and measured at end period.

7. **The net domestic assets (NDA) of the BCRA**

The net domestic assets (NDA) of the BCRA are defined, as shown below, as the difference between monetary liabilities and net international reserves (NIR) of the BCRA, both measured on the basis of end-of-period data.

The limit on NDA will be adjusted upward by the equivalent of purchases from the IMF under the arrangement in excess of US$4 billion.

The limit for December 2001 will be adjusted upward for up to Arg$200 million on account of temporary liquidity needs reflected in an equivalent increase in repos (*pases activos*).

	2001		2001 ceilings[1]	
	Mar.	Jun.	Sept.	Dec.
A. Net international reserves (a-b)	15,442	12,966		
a. Gross international reserves[2]	23,040	21,557		
b. Foreign liabilities[3]	7,595	8,591		
B. Net domestic assets (C-A)[4]	7,136	8,549	10,635	9,675
C. Monetary liabilities (c+d+e)	22,581	21,515		
c. Currency issued	13,554	13,067		
d. Government deposits[5]	1,116	474		
e. Reserve deposits of banks[6]	7,911	7,974		

[1]Performance criteria

[2]Includes the BCRA holdings of gold, SDR's, foreign currency in the form of cash and deposits abroad, government securities of investment grade of OECD countries, and Argentina's net cash balances within the Latin American Trade Clearing System (ALADI), excluding the accounting effects of holdings of reverse repo operations. This definition of reserves excludes central bank holdings of government bonds.

[3]Liabilities to the IMF valued at US$1.30 per SDR. For September and December 2001, it excludes purchases from the IMF arrangement in excess of US$4 billion.

[4]Includes claims on the government on gross basis.

[5]Includes government and ANSES deposits.

[6]Legal bank reserves and liquidity requirements (reverse repo).

Structural Benchmarks

Tax administration

- Implementation of plans to streamline tax payments facilities arrangements (5th review)
- Implementation of plan to strengthen tax collections described in paragraph 8 of the Memorandum of Economic Policies (5th review)
- Completing 80,000 and 100,000 desk audits (5th and 6th review, respectively)
- Full implementation of the Tax Frauds Tribunal (6th review)

Social security reforms

- Implementation of restructuring plan for family allowances (5th review)

Provincial finances

- Submission to congress of draft legislation agreed with the provinces to reform the revenue sharing arrangement (5^{th} review)

- Continuing publication by the Ministry of Economy of quarterly public reports on the implementation by the federal government and each province of commitments undertaken in pacto federal (5^{th} review)

Financial system

- Strengthening compliance with prudential and reporting requirements of the public banks and the commissioning of an external audit of the BPBA, as described in paragraph 17 of the Memorandum of Economic Policies (5^{th} review)