

**GENERAL AGREEMENT ON
TARIFFS AND TRADE**

RESTRICTED

BOP/261/Add.1
7 May 1986

Limited Distribution

Committee on Balance-of-Payments Restrictions

Original: Spanish

1986 CONSULTATION WITH ARGENTINA

Basic Document for the Consultation

Addendum¹

¹Supplementary material circulated by the Argentinian delegation in the Committee meeting of 23 April 1986.

1. Introduction

The present consultation is being held as a consequence of the restrictions adopted by Argentina because of serious balance-of-payment problems which reached a critical point in mid-1983.

In order to deal with those problems, the Argentine Government had to adopt a series of stringent measures designed to ensure orderly and adequate allocation of resources already available or which could be mobilized rapidly.

This situation cannot be viewed in isolation from the international context.

Normal operation of international trade and the international financial system are under severe strain. The crisis of international indebtedness which followed the oil crisis has become a major threat to stability of the international economic and financial system.

The steep rise in interest rates caused by restrictive monetary policies on the part of developed countries brought a substantial increase in debt servicing. This trend, in conjunction with suspension of the flow of capital toward developing countries, further aggravated the situation and obliged most of these countries, including Argentina, to bring their foreign payments to a virtual halt.

What is more, in recent years the developed countries have introduced various protectionist measures and production subsidies, particularly in the agricultural sector, which have had a direct and clearly apparent impact on temperate-zone developing nations, which are effective agricultural producers, more especially Argentina.

In the first place, as a result of these measures, developed-country markets have been entirely or partly closed to Argentina's exports.

In the second place, this closing of markets which has inhibited efficient foreign competition, together with the grant of domestic subsidies by developed countries to their agricultural producers, resulted in the accumulation of large surpluses of the products concerned, forcing down international prices and significantly reducing Argentina's export earnings.

In the third place, substantial surpluses have been released onto the international market through the grant of export subsidies (including preferential credits). This situation had the effect of displacing Argentina's exports from third markets to which there was already a trade flow, and rendering access to new markets impossible.

As a dramatic result of the developments mentioned above, one may cite exports of beef, one of Argentina's traditional exports which has accounted for an important share of the country's foreign deliveries. Whereas in

the 1960s and 1970s, exports of beef to the EEC were fluctuating between US\$300 million and US\$400 million, in 1984 their total value was only US\$68 million. Meanwhile, the EEC became the leading world exporter of the product, with an average volume of deliveries that increased from 50,000 tons between 1970 and 1973 to 500,000 tons between 1980 and 1983. This was achieved through substantial subsidies granted by the EEC, in amounts which since 1980 have well exceeded the total value of Argentina's annual meat exports.

In addition, this situation has displaced Argentine beef from traditional markets. One may mention by way of example the case of Egypt, and in October 1985 the sale of 175,000 tons to the USSR (more than twice the 1984 volume); in this latter transaction, the subsidy was accompanied by a substantial reduction in the selling price of meat held in storage by Community intervention agencies pending export of the product.

Another result of the policy under reference - already mentioned in the Argentine presentation - is the 21 per cent fall in international prices of cereals, Argentina's major export product, reflecting the pronounced down-trend in these prices.

Lastly, the sharp decline in Argentina's export earnings caused by the protectionist problems already mentioned was compounded by the chronic deterioration in the terms of trade of developing countries vis-à-vis developed countries, and steep increases in recent years in the international interest rate on loans granted to Argentina.

These external developments which have adversely affected Argentina are the reason for present balance-of-payments problems and consequently for the trade restrictions that have been adopted in order to offset them.

2. Balance of payments in the period 1980-1985

2.1 Period 1980-1983

As a result of the international situation already mentioned and an inappropriate commercial, monetary and exchange policy pursued by the preceding government, the balance of payments deteriorated appreciably over this period, as may be seen from the Table in Annex I. A recurring deficit was recorded in the current account, together with rapid deterioration of the capital account which was in deficit in the last two years.

This imbalance in the current account was attributable to a trade deficit in the first two years of the period. Although a surplus was recorded in the ensuing two years of the period, it was not sufficient to offset the growing deficit in the balance of services, mainly due to rising payments for financial services.

Deterioration in the current account over this period was attributable to growing difficulties of access to the international capital market, reaching a critical point in 1982 because of massive outflow of foreign private capital.

In order to deal with this situation, a temporary import régime was established in 1982 under Resolution S.C. 33/82 and extensions thereof, with the objective of preserving foreign exchange availabilities to the utmost. Under that Resolution and as an emergency measure in regard to foreign trade, detailed examination of Sworn Declarations of Import Needs (SDIN) was introduced, taking into account the extent to which the proposed imports were dispensable.

This measure, in combination with restrictions imposed on private capital outflow, checked to some extent the deterioration in the capital account in 1983.

2.2 Period 1984-1985

Although the difficult economic situation continued, the chronic deficit on current account was progressively reduced over this period. That deficit was almost exclusively attributable to payments for financial services, which outweighed the trade surplus.

Accordingly, after having reached \$4,700 million in the years 1980-1981 the deficit on current account dropped back to \$2,500 million in 1984 and \$1,250 million in 1985. This improvement was largely due to a reduction in imports - from \$10,540 million in 1980 to \$4,050 million in 1985.

This steep decline in imports was the result of the import restrictions (Decree 319/83 as extended by Decree 4070/84) which the Government had to impose on taking office in December 1983. That decision was unavoidable, having regard to the fact that no substantial increase in agricultural exports was feasible because of the decline in international prices of those products and the temporary imbalance between industrial production incentives and concrete results in foreign sales.

It should be noted that at 1980 prices, commodity shipment volumes in 1984 would have represented additional earnings in the vicinity of \$1,900 million.

The improved trade balance made it possible to cover increased interest servicing of the foreign debt. Those servicing costs climbed from \$2,200 million in 1980 to \$5,200 million in 1985.

3. Level of monetary reserves in the period 1980-1985

The balance-of-payments deficit already mentioned resulted basically from an increase in the real rate of interest payable on foreign indebtedness, deterioration of the terms of trade, and restrictions on the grant of new foreign loans. These factors brought strong pressure to bear on international reserve assets, making it necessary to incur foreign payment arrears as a supplementary financing mechanism.

Accordingly, when the new Government took office in December 1983, available reserves stood at only US\$100 million while the arrears totalled US\$3,200 million. At the end of 1984, and as a result of the emergency measures already mentioned, available reserves were around US\$650 million and arrears totalled US\$4,163 million; of this amount 54 per cent corresponded to interest due and 30 per cent to commercial debts, as against 36 per cent and 47 per cent respectively at the end of 1983.

The main financing sources for the balance-of-payments deficit of 1985 stemmed from agreements entered into with the International Monetary Fund (IMF) (US\$1,007 million), foreign banks (US\$3,069 million), and the Paris Club (US\$2,138 million), which made it possible not only to finance the deficit for the year but also to have adequate liquidity of international reserves and to reduce external payment arrears to US\$1,640 million at the end of last year.

4. Plan Austral

4.1 Background

At the beginning of 1984, in the context of an economic programme backed by a standby arrangement with the IMF, adjustments were made to credit policy, public sector prices and the exchange rate; in addition the price control policy established when the new Government took office was liberalized to some extent.

Nevertheless the monetary expansion rate continued high and inflation could not be slowed down.

4.2 Inflation

During the first nine months of 1984, the Government endeavoured to lower the inflation rate, by adjusting certain variables on a monthly basis (prices of public-sector goods and services, prices of goods subject to control, currency depreciation rate and interest rate) in line with targets for lowering the inflation rate.

Notwithstanding these measures, the consumer price index reached a monthly increase rate of nearly 23 per cent in the third quarter of 1984. The increase rate of consumer prices rose progressively from a low of 12.5 per cent in January 1984, fluctuating to reach a peak of 27.5 per cent in September, and declining slightly in the last quarter of the year.

This pattern of gradual increases resulted in serious price distortions in relative prices during this period. The national currency appreciated considerably in real terms, prices of services furnished by public undertakings declined, and the price control system led to increased distortions in the industrial sector. Furthermore, the recovery in economic activity which had begun in the second half of 1982, triggered by a consumption increase, slowed down in mid-1984.

4.3 Gross domestic product

Gross domestic product rose by 2.5 per cent in 1984, while internal expenditure, at constant prices, increased by more than 3 per cent, reflecting a rise in the growth rate of private consumption. Public-sector consumption declined slightly in this period, while investment fell back more rapidly than in 1983 as a result of a fall in both private and public investment.

4.4 Public sector

The public-sector deficit (excluding transfers to public undertakings) declined from 11.5 per cent of GDP in 1983 to 8 per cent of GDP in 1984, due to a decline in costs and a slight increase in income.

Despite the adoption of certain tax measures, fiscal revenue increased only marginally in this period. Tax revenue moved from nearly 19 per cent of GDP in 1983 to almost 20 per cent of GDP in 1984, the major part of the increase being attributable to higher employer contributions corresponding to wage payments.

4.5 Monetary policy

During this period, the Central Bank endeavoured to keep interest rates at the level of the inflation rate, but except in the last months of 1984 they remained substantially below the latter.

The extent of negative real interest rates in the regulated sector led to rationing of credit and to the development of an entrepreneurial market outside the institutionalized financial system. Until the end of 1983, the banks were allowed to compete with the entrepreneurial market through the issue of bank acceptances. The amount of such acceptances was limited for each bank to ceiling levels which were raised substantially during 1984.

In parallel, measures were taken to encourage swap operations, and free-rate deposits accounted for a substantial proportion of total bank deposits. In the latter months of 1984, the authorities took measures to limit the rôle of the Central Bank in financial intervention, and to increase flexibility of the financial system.

4.6 Commercial and exchange policy

When the new Government took office in December 1983, broad restrictions and multiple exchange rates were in operation in foreign trade and the exchange rate system.

Restrictions on the use of foreign exchange resulted in external payment arrears in respect of current transactions. In October 1983, a foreign exchange allocation system was introduced for imports, the sale of foreign exchange for certain current transactions was suspended, and Central Bank authorization was made compulsory for other transactions.

Payment for services for which foreign exchange was not available could only be made through the purchase of external vouchers (Bonex). Substantial discounts were applied on the sale of the latter abroad in return for foreign exchange, resulting in multiple exchange rate practices.

In January 1984 the foreign exchange allocation system was replaced by a new system of quantitative import restrictions. Subsequently, in August of that year, an automatic scheme was introduced for payment of private sector imports.

4.7 Economic situation in the first half of 1985

During the first quarter of 1985, and despite the measures applied by the Government from the beginning of the preceding quarter (consistently with the understanding sent to the IMF in September 1984), there was a fresh surge in the general level of domestic prices, which reached 30.5 per cent in June 1985.

Meanwhile, on the external front, balance-of-payments results were weakened, as already mentioned, owing to a pronounced downward trend in grain prices on international markets, by almost 21 per cent from preceding levels.

In view of this situation, it was considered necessary to bring into operation an economic programme, termed "Plan Austral", that triggered a drastic and immediate disruption of the inflationary spiral which had been besetting the Argentine economy for many decades. To that end, and in order to avoid a deep recession, income policy was combined with a drastic reduction in the budget deficit. The objectives of these policies were to modify expectations, moderate the growth of aggregate demand and act directly on prices.

Consequently, various measures were taken beginning with the second quarter of 1985.

4.7.1 Measures to ease the difficult external situation and improve the fiscal position

There was a devaluation of 18 per cent to help make up for the decline in competitiveness between August 1984 and May 1985, which amounted to an accumulated loss of 26 per cent. This was accompanied by higher tax deductions on traditional exports.

4.7.2 Financial reform

At the end of May 1985 there was a reform designed to reduce the regulations imposed on the institutionalized financial system and to increase the number of transactions previously effected.

4.7.3 Monetary reform

A shock strategy was adopted to do away with the inflationary problem. It included creation of a new currency with an equitable disindexation of existing contracts; freezing of prices, wages, public-sector charges and the exchange rate; and elimination of the financing of the fiscal deficit by the issue of currency.

4.8 Results

Significant results have been achieved in the implementation of the Plan Austral. First, there was a sharp decline in wholesale-price indices (a high of +1.5 per cent in August and a low of -1 per cent in July) and in the consumer price index (which fell to levels varying between 1.9 and 3.2 per cent between July and December).

Secondly, the financing requirements of the public sector fell, as a percentage of GDP, from 7.14 per cent in the first quarter of 1985 to 2.4 per cent in the fourth quarter of that year. In other words, the major corrective applied to the public finances reversed the previous trend. Thus, the fiscal deficit for the second quarter of 1985 was less than the interest due on the external public debt, and the Treasury was not obliged to turn to the Central Bank of the Argentine Republic.

The financial markets showed significant changes when the Plan was launched, with increased demand for local-currency assets, although the liquidity ratio continued low by comparison with its historic levels. Fixed interest rates, too, were much lower than during the previous period, although they remained appreciably above the rise in prices, and real interest rates were particularly high for those sectors in which the price freeze was strictly applied. The differentials in yield earned by different assets (foreign exchange, indexed deposits, fixed-interest deposits) led to swift portfolio adjustments which had to be absorbed by the Central Bank at high cost.

Consequently, it may be said that the economic results of the Plan Austral fall within the forecasts of governmental authorities, as a result of which those for the external sector show a greater tendency towards balance.

Nevertheless, there are important factors beyond the control of the economic authorities that may have a significant influence on developments in the external sector. Among them may be mentioned the protectionism of the developed contracting parties and the unfair competition practised by those countries through direct subsidies and credit on favourable terms in the farm-products sector, which affects the main source of Argentina's export earnings.

Also worth mentioning is the high interest rates, already referred to, prevailing on the international financial market, which are causing a vast outflow of external assets and further limiting Argentina's ability to pay.

5. System of restrictions and how it is applied

5.1 Evaluation of import restrictions

To deal with the problems mentioned above S.C. Resolution No. 33/82 (extended by S.C. Resolution Nos. 172/, 19/83 and 163/83) established a temporary import régime from 3 May 1982 until 31 December 1983, for the various tariff headings indicated therein, with the exception of goods negotiated with the Latin American Integration Association (LAIA), the Central American Common Market, and Cuba, Haiti, Panama and the Dominican Republic.

The régime was designed to preserve the availability of reserves and to that end it was necessary, as a foreign-trade emergency measure, to examine very closely the Sworn Declarations of Import Needs (SDIN) and to consider the extent to which the goods being declared were dispensable.

Subsequently, when the Constitutional Government was installed, a new import régime was established by Decree No. 319 issued on 29 December 1983, which by virtue of its extension by Decree No. 2045/84 applied until 31 December 1984.

This régime was based on the targets fixed for the development of the external sector of the economy, targets which made it necessary to ensure reactivation of the economy simultaneously with a suitable trend in the balance of payments. In addition, as already explained, the economic situation required the implementation of a cautious import policy.

Under this régime, a temporary prohibition was imposed on products which, by their nature and destination, were of a non-essential character - i.e. not indispensable for the country's economic development - whose acquisition abroad adversely affected the balance of payments. Such products were listed in Annex I to the Decree.

Similarly, Annex II to the Decree, contained a list of goods subject to examination, in view of their sensitive character in the sense of their possible replacement by domestically produced goods.

The objective of this measure was to promote full utilization of the country's human and material resources, in view of the fact that these restrictions did not serve to affect either industrial development or the adequate supply of the domestic market, despite the establishment of a careful administration of foreign-exchange availabilities. Special care was taken to ensure smooth administrative procedures and greater fluidity in the supply of imported inputs and capital goods for production.

Subsequently, Decree No. 4070, issued on 28 December 1984, replaced that import régime while maintaining the previously mentioned objectives and to some extent modifying the classification of products listed in the aforementioned Decrees.

Under Article 2 of the new Decree, the suspension of imports of the goods listed in Annex I expired on 30 June 1985. As from that date, they were shifted to Annex II. In other words, this measure lifted the import prohibition, and these products were thereafter subject only to prior examination, like the other goods listed in Annex II.

What is more, in the course of 1985, a process of facilitating imports was initiated through various legal provisions. Many products were dropped from Annex II of Decree No. 4070/84 (Resolutions No. 154 of 28 March 1985, 413 of 29 July 1985 and 978 of 30 September 1985) and were made automatically importable, i.e. without prior examination.

Meanwhile, Decree No. 319/85 had instituted the requirement to lodge an equivalent bank deposit before being able to import. This measure was extended by Decree No. 4070/85. As a form of liberalization, the requirement was lifted by S.C.E. Resolution No. 562 of 24 September 1985 (capital goods and their replacement parts), and it was eliminated for almost all products by Resolution No. 647 of 25 October 1985.

At the present time, the bank-deposit requirement applies only for some non-industrial consumer goods considered highly dispensable luxury products.

5.2 Régimes applicable to imports of different origins

The temporary prohibition established by Decree No. 319/83 and its extensions, which as mentioned applied until 30 June 1985, made provision for the case of the products imported under the concessions granted by Argentina in the Partial-Scope Agreements and Market-Opening Regional-Scope Agreements of the Latin American Integration Association (LAIA), whereby, such imports were excluded from the temporary-prohibition régime. Imports originating in the LAIA countries accounted for 3.32 per cent in 1982 and 3.61 per cent, of the annual total.

5.3 Tariff increase

For fiscal purposes and with a view to contributing to a still better budget balance, M.E. Resolution No. 476/85 was approved on 11 June 1985. It increased import duties by ten points for a period of 180 days, which has been extended by M.E. Resolution No. 268/86 of 20 March 1986 to 31 December 1986.

6. Outlook for 1986

6.1 Estimates for 1986

Argentina's economic life has been frustrated during the last 35-40 years by inflation and economic stagnation. The Plan Austral made it possible to reduce inflation from 30-40 per cent monthly to 2-3 per cent. To cope with the anti-inflationary objective it is necessary to continue to

contract the fiscal deficit and not to have recourse to the issue of currency to finance public expenditure. These objectives will be reflected in a fiscal deficit of 2.89 per cent. In turn, growth will be achieved through a rate of investment higher than that of recent years (8.2 per cent of GDP), and through an export programme designed to increase industrial exports by 30-40 per cent.

6.2 Fiscal deficit

The consolidated deficit of the public sector will amount to 2.89 per cent of GDP, which means a significant reduction from that of 1985 and a drastic change from the imbalance that characterized the public sector prior to the Plan Austral (in 1984 the deficit amounted to 12.01 per cent and in 1983 to 15.64 per cent of GDP).

TREND OF THE PUBLIC-SECTOR BUDGET

(in per cent of GDP)

Year	Expenditure			Total receipts	Deficit
	Total current capital				
1983	37.5	28.7	8.8	21.9	15.6
1984	35.0	27.2	7.8	23.0	12.0
1985	32.8	25.1	7.7	27.3	5.5
1986	31.2	23.0	8.2	28.3	2.9
Changes					
1986-1983	-6.3	-5.7	-0.6	+6.4	-12.7

From the above Table one can appreciate the strong fiscal improvement - which will be even greater in 1986 - brought about by the Constitutional Government. It is worth pointing out that the decline is occurring mainly in current expenditure (-5.7), while capital expenditure is receding only slightly (-0.6).

The estimated deficit for the public sector will not be financed by the issue of currency, thereby maintaining the decision taken as from the second quarter of 1985. It will be dealt with basically through the use of external credit.

6.3 Inflation outlook

The maintenance of a low fiscal deficit will help to support the anti-inflationary policy pursued by the National Government. This makes it possible to estimate, for 1986, an average rise as between wholesale and retail prices of the order of 28 per cent for the year.

6.4 Strengthening of the fiscal position

The improvement, over 1985, in income expected for 1986 will be particularly aided by the growth of tax receipts. This will be due to changes that will take effect during the present year (changes in the tax rates on bank debt, changes in the tax base of profits, capital and net-assets taxes and reduction of the lag between accrual and collection of the value-added tax. In export duties, a reduction is planned as a result of lower duties on products with a view to improving the production earnings of that sector. The collection of import duties will increase owing to the expected higher level of activity for 1986.

6.5 Level of economic activity

An average 4 per cent growth over 1985 is expected in economic activity. The National Government's policy is centred on the need to reduce current expenditure and increase public investment. For 1986, current expenditure will have to be reduced from its 1985 level by 2.1 per cent of GDP, while capital appropriations will be increased by 0.5 per cent of GDP. This will mean a decline of 1.6 per cent of GDP in total expenditure.

An aspect to be stressed is that the trend which began in 1985 towards higher savings, in the public sector, is intensifying. In 1986, current receipts will exceed current expenditure and this will contribute to a savings level of 3.7 per cent of GDP. Consequently, approximately 50 per cent of the real investment by the public sector will be financed by genuine resources.

This greater self-financing, in conjunction with higher public investment, highlights the objective of growth with stability.

Lastly, in the sphere of trade and industrial policies there are two points worth noting:

- . First, the special export programmes, which will help to increase industrial exports in 1986 by between 30 and 40 per cent;
- . Secondly, the promotion of industrial projects, to which greater resources will be allocated than in 1985; similarly, agro activities will be fortified: fertilizer plants, forestry, production of wool and tea.

ANNEXESTIMATE OF BALANCE OF PAYMENTS 1980-1985

(in US\$ Million)

ITEM	1980	1981	1982	1983	1984	1985*
<u>CURRENT ACCOUNT</u>	<u>-4768</u>	<u>-4714</u>	<u>-2358</u>	<u>-2461</u>	<u>-2492</u>	<u>-1665</u>
GOODS	-2519	-287	2287	3331	3500	4102
Exports f.o.b.	8021	9143	7624	7836	8100	8302
Imports c.i.f.	-10540	-9430	-5337	-4505	-4600	-4200
REAL SERVICES	-740	-705	43	-400	-283	-316
FINANCIAL SERVICES	-1532	-3700	-4719	-5408	-5712	-5460
UNILATERAL TRANSFERS	23	-22	31	16	3	9
<u>CAPITAL ACCOUNT</u>	<u>2275</u>	<u>1155</u>	<u>-3808</u>	<u>-111</u>	<u>748</u>	<u>490</u>
DIRECT INVESTMENT	788	927	257	183	269	851
COMMERCIAL FINANCING	-115	-3386	-2720	-411	524	-710
OTHER	1502	3614	-1345	117	-45	349
<u>CHANGE IN NET INTERNATIONAL RESERVES</u>	<u>-2493</u>	<u>-3559</u>	<u>-6166</u> ^{1/}	<u>-2572</u> ^{1/}	<u>-1744</u>	<u>-663</u>

¹ Including adjustments for operations not corresponding to the period

* Projected figures

Balance-of-Payments Department
Central Bank of the Argentine Republic