Buenos Aires, September 10, 2003

Dear Mr. Köhler:

1. Over the past year, we have made considerable progress in overcoming the macroeconomic instability associated with the economic and financial crisis of 2001–2002. The positive results are becoming more apparent. The implementation of our program provided the basis for a rebound in confidence, recovery in output, and strengthening of the financial variables. These conditions facilitated important policy actions such as lifting restrictions on bank deposits, easing foreign exchange controls, and initiating monetary reunification through the redemption of quasi-monies.

2. The challenge ahead is to consolidate the gains and build a prospering economy that benefits the Argentine people, while reducing the vulnerability to future shocks. The main objectives are to protect the more vulnerable parts of the society and support the growth potential of the economy through needed social and infrastructure investment in order to promote durable and equitable growth with continued low inflation. In this context, we intend to strengthen the public finances as needed to establish conditions for a successful public debt restructuring that assures debt sustainability. We will also take all necessary measures to strengthen the soundness of the banking system to facilitate greater credit to the economy, help normalize the business climate, and re-establish Argentina's position in the world community.

3. The attached Memorandum of Economic and Financial Policies (MEFP) lays out in detail our economic program for the remainder of 2003 and for 2004–06 and requests a new Stand-By Arrangement for a period of 36 months from the Fund in an amount equivalent to SDR 8,981 million (equivalent to some US$12.5 billion) in its support. We also request that the repurchase expectations arising during the first year of the Arrangement be moved to an obligation basis.

4. The program is based on the World Bank and the IDB maintaining the current level of their exposure to Argentina. We intend to work closely with the multilateral development banks to ensure that their disbursements are closely in line with the program. This will be key to protecting international reserves and to the consistency of the Program. The government is committed to pay interest on all IFI debt from its own resources.

5. During the period of the requested Arrangement, the government will maintain a continuous dialogue with the Fund, in accordance with the policies on such consultations, on the adoption of any measures that may be appropriate to achieve the objectives of the program. The program will be monitored through regular reviews, quantitative performance criteria and indicative targets, and structural performance criteria and structural benchmarks. The reviews will be held quarterly for the duration of the Arrangement. These reviews will also be

associated with financing assurances reviews for the period while sovereign arrears to the private sector persist. The structural objectives for 2004 will be further detailed during the first and second reviews of the program.

Yours sincerely,

/s/	/s/	/s/
Dr. Roberto Lavagna	Lic. Guillermo Nielsen	Lic. Alfonso Prat-Gay
Minister of Economy	Finance Secretary	President of the Central Bank

Attachment

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF ARGENTINA FOR 2003–06

I. INTRODUCTION

1. In the aftermath of Argentina's deepest economic crisis, the newly elected government is fully committed to rebuilding an economy that delivers sustained growth within a framework of social equity. Given the legacy of the crisis—in particular, still-widespread poverty, the large debt overhang, and an impaired banking system—this will require a wide range of economic, social, and institutional reforms aimed at restoring prosperity to the Argentine people, and affirming Argentina's position and reputation within the world economy. These changes can best be achieved within a medium-term policy framework that is supported by the international community.

2. Since mid-2002, and more recently in the context of the transitional program, significant progress has already been made toward establishing a growth momentum and bringing back confidence to businesses and consumers. In addition, inflation and interest rates have been brought down rapidly and the financial system has been stabilized. The government has strengthened the social safety net to help alleviate poverty. Prudent fiscal and monetary policies under the transitional program have been key to improving the macroeconomic situation, and allowing the progressive dismantling of emergency measures taken at the time of the crisis. In particular, the government has been able to lift restrictions on bank deposits, ease major foreign exchange controls, and proceed toward monetary reunification with the redemption of most quasi-monies.

3. The government's new medium-term program for the period through 2006 is based on continued prudent macroeconomic policies combined with a broadening and deepening of structural reforms, and an orderly restructuring of sovereign debt. The key elements of the program are as follows:

- A macroeconomic policy mix to enhance growth and entrench price stability;
- A robust fiscal framework that will anchor fiscal discipline at both the federal and provincial levels, provide adequate resources for social policies and public investment, and allow a level of public savings consistent with normalizing relations with creditors;
- An orderly public debt restructuring that—combined with the envisaged fiscal effort—will help lead to debt sustainability, and allow Argentina to regain responsible access to international capital markets;
- Steadily strengthening the soundness of the banking system—both in the private and public banks—which will facilitate greater credit expansion, essential to maintaining the growth momentum;

- Reforms to provide for greater independence and accountability in the implementation of monetary policy—leading to an inflation targeting regime—and in conducting financial sector supervision; and

- Measures to improve the investment climate, including assuring a predictable legal framework, a strategy for the privatized utility companies, and an appropriate legal and institutional framework to facilitate the speedy restructuring of troubled corporate debts.

4. The proposed agenda is ambitious, but measures have been carefully sequenced to ensure widespread consultation and secure the necessary broad support for the program. During the first year of the program, the government will continue with fiscal discipline, move quickly to a debt restructuring agreement with creditors, implement a strategy for compensation and recapitalization of commercial banks to help expand credit and begin phasing out forbearance in bank regulations, carry out audits and strategic reviews of the leading public banks, adopt a comprehensive strategy for the utilities, and establish a corporate debt restructuring framework. During this period, preparations will also be underway for structural and institutional reforms which will be implemented during the second and third years of the program, including the structural fiscal reforms needed to put the public finances on a sustainable basis.

II. Medium-Term Macroeconomic Framework

5. The medium-term macroeconomic framework, on which the government's program is based, envisages that the economy would continue to expand at a sustained pace, while underlying inflation would remain in the single digit range. Output is expected to grow by 5–6 percent in 2003, owing to a strong rebound in investment in the sectors that benefited from the real depreciation of the peso, and a gradual recovery in consumption and exports. In 2004–06, growth is expected to reach about 4 percent while potential output is being strengthened. On prices, while headline inflation is likely to rise from its current low level, monetary policy will target inflation to be brought back to current levels (4–7 percent) by the end of the program period.

6. With the sustained economic recovery and a modest strengthening of the real exchange rate, the surplus in external trade and nonfactor services is projected to decline gradually during the program period, while still remaining relatively large at about 6½ percent of GDP in 2006. Export volume growth should strengthen further during the program period, although this is expected to be outweighed by a recovery in imports (which will still remain well below the pre-crisis level). In the capital account, despite a projected improvement in net private capital inflows, we expect external financing gaps of US$4.3 billion in the remainder of 2003, and about US$13 billion in 2004–06, mainly reflecting the need to restructure public and private debt, and to rebuild reserves to more comfortable levels.

7. We are confident that these gaps can be closed through a combination of: (i) the restructuring of public and private debt; (ii) a rescheduling of arrears and current obligations to Paris Club and other bilateral creditors; and (iii) continued support from the IMF, the World Bank, and the IDB. Exposure of the IMF, World Bank, and IDB will remain constant over the program period and Argentina will pay interest to the international financial institutions from its own resources. A necessary condition for the success of the program is adequate support from the multilateral development banks during the program period to help close the projected external financing gaps. This would provide greater certainty, in particular, regarding the government's ability to meet project, sectoral, and social development needs, following the substantial net debt service payments made to the multilateral development banks in the wake of the crisis. The World Bank's lending program will be developed in the context of the Bank's forthcoming Country Assistance Strategy.

Macroeconomic Framework 2003–06

	2003	2004	2005	2006
	(Annual percent change)			
Real GDP	5.5	4.0	4.0	4.0
Consumer prices	5–6	7–11	5–8	4–7
	(Percent of GDP)			
Public sector primary balance	2.5	3.0	...	...
Trade and nonfactor services balance	11.6	8.8	7.5	6.3
	(In billions of US dollars)			
Gross international reserves	13.5	15.4	...	...

8. Fiscal discipline in the context of strong sustainable growth, job creation, and poverty reduction is at the core of the government's plans to deal with the large debt overhang. The aim for 2004 will be to establish a consolidated primary surplus of 3 percent of GDP. In subsequent years—2005 and 2006—policy will ensure an extension of the trend initiated in the year 2002, and strengthened in 2003 and 2004, so as to produce levels sufficient to cover net payments on performing debt and obligations that may result under a debt restructuring agreement. Accordingly, fiscal policy will provide a sound basis to assist in ordering relations with creditors, restoring market access, and ensuring debt sustainability, while meeting growth, employment, and social equity objectives.

9. On the basis of the medium-term framework, it is envisaged that the debt-to-GDP ratio could be reduced gradually in the medium term from about 150 percent of GDP projected for December 2003. Once the public debt restructuring is finalized, uncertainties for the private sector will be reduced, and Argentina will be placed on a firm path toward debt sustainability, giving the prospect of a responsible return to international capital markets. The government has the intention to minimize any additional debt issuance.

III. Economic and Financial Policies for 2003–04

A. Fiscal Policy

10. It remains our objective to achieve a consolidated primary surplus of 2½ percent of GDP in 2003, as envisaged under the transitional program. Tax revenues have been higher

than projected, and provide room for accommodating additional spending—mainly on public investment—in support of the recovery.

11. In 2004, fiscal policy will aim to strike a careful balance between providing support for public investment and economic growth, and continuing on the path of achieving the primary surpluses needed for medium-term sustainability. Thus, the consolidated primary surplus will be increased to 3 percent of GDP, with the adjustment taking place primarily at the federal level. The primary surplus at the provincial level would be increased to about 0.6 percent of GDP.

Federal budget

12. The federal budget to be submitted to congress by September 15 for passage by end-December 2003 (structural performance criterion) will target a primary surplus of 2.4 percent of GDP (above 2.1 percent of GDP expected in 2003). The higher surplus reflects mainly: (i) improvements in tax compliance as a result of the administrative reforms submitted to congress in June that we expect to be approved by end-November; (ii) termination of the competitiveness plans (structural performance criterion for end-December 2003); and (iii) continued tight control over primary spending, which should allow an important increase in public investment within the targeted primary expenditure-to-GDP ratio of about 17.9 percent of GDP.

13. The federal revenue ratio in 2004 is targeted at 20.3 percent of GDP. As the revenue yield from the tax administration measures is not easy to calculate with precision, the government is prepared to introduce contingency revenue measures by April 2004 if revenues fall below projected levels for the first quarter. This will be done, if needed, by increasing excises on alcohol and luxury goods, reducing cross-crediting of the fuel tax against the VAT and the income tax, and by including excises in the base for the VAT. The government has committed to exporters to eliminate the stock of arrears on their VAT refunds by March 2004 (structural benchmark).

14. Federal primary spending in 2004 is targeted at 17.9 percent of GDP, compared with 18.2 percent of GDP in 2003. The federal wage bill is budgeted at about 2.7 percent of GDP, and will remain an essential fiscal anchor for the program. These spending targets do not include debt recognition expenditures paid with bonds (about 0.7 percent of GDP). All cash payments, including for debt recognition, will be contained within the primary ceiling.

15. With poverty levels still high, the government attaches key importance to maintaining a strong core social safety net, which has recently been strengthened by the inclusion of a new nutrition assistance program and a new community development program (*Manos a la Obra*), and the provision of a stipend to those over 70 years of age without a pension (*Plan Mayores*). The government will continue to work towards improving the efficiency and targeting of the *heads of household* program by: (i) ensuring that the benefits are maintained appropriately below the low-skilled wage level; (ii) implementing strict supervision of the registration process; (iii) enforcing the work requirements, while improving the usefulness of

workfare activities; and (iv) improving the process of responding to complaints and irregularities. The government will design a longer-term social assistance strategy by end-2003, consistent with its broader poverty alleviation strategy, including clearly specifying the responsibilities between levels of government for financing and implementation of social programs.

16. In 2004, given the government's limited market access, gross external financing from the World Bank and the IDB would be required of about US$1.2 billion. During the year as a whole, no recourse will be made to central bank credit—except on a transitory basis and within the ceiling established by congress—in order to facilitate base money control and underpin the inflation objective of the program.

Provincial government finances

17. Fiscal discipline at the level of the provinces is to be anchored in the annual bilateral agreements, which will continue to operate until broader reforms of intergovernmental finances are in place. The 2004 bilateral agreements will include primary surplus targets, and will be complemented by steps to improve tax administration through broader exchange of information and cross-checking between federal and provincial tax administrations. Any deviations from the primary surplus targets as a result of project disbursements financed by the MDB's will be offset by an adjustment, if necessary, at the federal level. Provincial spending plans for 2004 will not include debt recognition expenditures, amounting to 0.4 percent of GDP, and repayment of arrears equivalent to 0.1 percent of GDP. Signature of the bilateral agreements by the key provincial governors is expected by mid-February 2004, and ratification by their provincial legislators is expected by end-March 2004 (structural performance criterion).

B. Public Debt Restructuring

18. The government is committed to a comprehensive and orderly restructuring of public debt that is consistent with eliminating financing gaps and achieving medium-term sustainability. We believe that a collaborative dialogue with creditors and our commitment to treat all creditor groups in a fair and equitable manner will help secure a high participation rate in the eventual restructuring. To this end, the government has already taken the following key steps:

- We have defined a medium-term macroeconomic framework in which debt restructuring can take place.
- We have appointed legal and financial advisors to assist in designing a framework for the debt restructuring and in managing relations with creditors.
- Selected representative private creditors have been invited to join consultative working groups organized to elicit inputs from private creditors and provide a forum for more focused discussions of restructuring proposals. Four groups were formed,

one representing global institutional investors and three representing retail creditors from Germany, Italy, and Japan. The menu of instruments will be formulated in a manner to ensure intercreditor equity.

- We are setting up targeted websites to disseminate information on debt and other data relevant to investors in different languages and have made our investor relations website more user friendly. The website will report promptly and regularly to investors at large about the content of discussions with creditor groups.

19. After further meetings with the consultative working groups, the government intends to announce the basic features of a restructuring offer in conjunction with the IMF/World Bank Annual Meetings in September, 2003. This announcement will clarify the scope of debt to be restructured, the treatment of initial claims and past due interest, and the general terms of the new debt instruments to be issued in the exchange (structural benchmark).

20. While a precise timetable for debt restructuring is difficult to project, we are determined to seek a speedy resolution of the debt restructuring and would hope to complete it by mid-2004. We will keep Fund staff informed of progress in reaching a restructuring agreement that is consistent with medium-term sustainability.

C. Monetary and External Policies

21. During the transition to an inflation targeting regime, the monetary anchor in 2003–04 will continue to be base money (augmented by remaining quasi-monies in circulation) in the context of a floating exchange rate regime. The monetary program aims at maintaining inflation close to 5–6 percent by end-2003, although it is expected to rise temporarily above this range in 2004.

22. To achieve these targets, some moderation in base money growth is planned after the significant remonetization that took place in the first half of 2003. Thus, the monetary program targets base money growth at about 10½ percent during September–December 2003 (compared with an estimated 17½ percent in January–August), and targets growth of about 12½ percent in 2004. It is envisaged that the growth of base money in the period would continue to largely reflect international reserve accumulation, and that the net domestic assets of the central bank would be broadly unchanged through 2004. Gross international reserves are projected to be US$14.0 billion by end-2003, and to rise to about US$15.6 billion by end-2004.

23. Within NDA, there would be no net lending to the government except as specified in paragraph 16, and lending to banks would be according to the established liquidity triggers. As under the transitional program, flexibility will be needed in adapting the program targets given continuing uncertainties with respect to the evolution of money demand.

24. Consistent with the 2002 undertakings of the provinces to strengthen their public finances under the Orderly Financing Program, the redemption of provincial quasi-monies shows continued progress, exceeding expectations under the transitional program. The

introduction of simplified exchange channels, the successful initiation of the process of redemption of *patacones* and *lecops* (issued by the Province of Buenos Aires and the federal government—the two largest issuers of quasi-monies), and the broad participation in the initiative, have already resulted in the retirement of approximately 57 percent of the stock of quasi-monies in circulation. This outcome is contributing to the ongoing recovery and enhancing fiscal transparency. We expect redemption of quasi-monies to be virtually completed by end-2003.

25. The administrative restrictions and controls introduced in 2001–02 have been largely liberalized. With financial stability more entrenched, we intend to phase out all remaining exchange controls during the program period. In this context, we intend to eliminate the export receipts surrender requirement by July 2004.

26. To bolster the potential of the export sector, we will seek to remove disincentives to exporters for example by phasing out export taxes and eliminating delays in VAT refunds. In addition, we intend to seek to increase trade openness by phasing out special regimes in line with existing Mercosur commitments by January 1, 2006, and by continuing active participation in multilateral and regional trade negotiations to establish a more liberal trade environment.

IV. Structural Reforms

A. Structural Fiscal Reforms

27. The primary surpluses compatible with fiscal sustainability will be based on reforms of tax policy, tax administration, public expenditure management, social security, and intergovernmental relations. The government will make technical preparations for these reforms during 2003–04, with most elements introduced in the context of the 2005 budget.

28. Tax reform will aim at making the system more conducive to growth and phasing out the distortive taxes that were introduced for emergency purposes. The tax reform would be initiated in mid-2004 with a first step being the reduction of the financial transactions tax. Consideration will be given to allowing the tax to be partially credited against the income tax during the phase-out period. Following this first step, more comprehensive tax reform legislation will be submitted to congress by September 2004 to be approved along with the 2005 budget. This will include, *inter alia*: (i) the broadening of the VAT base, through elimination of exemptions except for socially sensitive items, remaining cross-crediting, and the inclusion of excises in the VAT base; (ii) better aligning excises with regional levels; (iii) measures, including administrative reforms, to better define and make more equitable the payment of income taxes; (iv) streamlining administration by subjecting interest and dividend income to final withholding; (v) a phased elimination of the export tax beginning January 1, 2005; and (vi) significant further simplifications of the tax laws to facilitate tax compliance and reduce administrative burdens.

29. Strengthening tax compliance and reducing tax evasion is a major objective for the government and will complement tax policy reform. The government has recently submitted

to congress an anti-evasion package aimed at strengthening the enforcement capabilities for the federal tax administration (AFIP) and reducing the scope for evasion. These measures are aimed at tackling tax evasion resulting from: (i) phantom businesses created for the sole purpose of evading taxes; (ii) abuses in transfer pricing and operations with tax havens; (iii) the use of false VAT invoices; and (iv) the employment of unregistered workers. Approval of the legislation is expected by November 2003 (structural performance criterion). In addition, tax tribunals have recently become operational and 60 large cases are expected to be heard by the tribunals by end-2003. A second tax administration reform will be launched in late 2003/early 2004 (structural benchmark for the first quarter 2004), which will aim at improving compliance in the areas of customs and social security. The reform package would seek to strengthen custom audits and border controls to reduce under-invoicing and smuggling; as well as to tighten controls on the self-employed to reduce informality. To underpin tax compliance, the government will continue with its policy of not granting tax amnesties (continuous structural performance criterion).

30. Public expenditure management reforms will include: (i) the gradual incorporation of spending agencies that are currently not consolidated into the central administration's budget and treasury system; (ii) the inclusion of contingent liabilities and tax expenditures in the budget; and (iii) the adoption of common standards for budget coverage, classification and accounting at all levels of government to enable reporting on consolidated government activities in a timely and accurate manner. We propose to develop an action plan in these regards by mid-2004 in time for the reforms to be reflected in the 2005 budget. In addition, a pilot project for an integrated financial management information system is to be initiated in one province with technical assistance from the Fund with a view to adopting such systems in the remainder of the provinces in 2005–06.

31. Our focus on intergovernmental reform will be with respect to the tax revenue sharing arrangements, the introduction of binding debt and deficit limits for provincial governments, reforms aimed at strengthening provincial revenue capabilities, and the creation of a fiscal federalism agency capable of guiding future intergovernmental relations. These reforms will require legislative passage of a revised co-participation law and a fiscal responsibility law. To advance the reform effort, we propose to reach a formal agreement with the provincial governors on these objectives by end-March 2004 (structural performance criterion). Submission of agreed reform legislation to congress would follow by end-May 2004, with ratification by the federal and provincial legislatures by end-August 2004.

32. The government is committed to ensuring the long run sustainability and performance of the social security system. In this regard, social security reform measures are being prepared aimed at extending the coverage and increasing the efficiency of the system. Legislation will be submitted to congress by March 2004 with the aim of passage by September 2004.

B. Financial System Reforms

33. The key elements of the banking strategy are: (i) strengthening the institutional framework; (ii) strengthening the soundness of the banking system; and (iii) identifying the role of public banks and putting them on a sound financial footing.

Strengthening the institutional framework

34. To further enhance the effectiveness and transparency of monetary policy in pursuing the program's medium-term inflation objectives, the central bank and the ministry of economy and production are working together to set the stage for launching an inflation targeting regime that will be formally introduced by end-2004. In June 2003, a task force was established in the central bank (*Comité de Metas de Inflación*) which is undertaking preparatory technical work focusing especially on: (i) defining the appropriate formulation of the inflation target; (ii) improving understanding of the monetary policy transmission mechanism; and (iii) preparing a comprehensive communication strategy. An additional central bank working group has been established to consider the desirability of changes to the central bank charter, including to propose possible measures to enhance both independence and accountability to the congress and the public. The working group will present its recommendations by March, 2004 (structural benchmark) and legislation will be submitted by June 2004.

35. The credibility and success of inflation targeting will require a joint commitment to the regime by the BCRA and the ministry of economy and production. It is envisaged that the minister of economy and production and the president of the BCRA will, by the third quarter of 2004, jointly announce the inflation targets for 2005 and 2006.

36. The government is considering, jointly with inflation targeting, the creation of a regulatory agency (separate from the central bank) that will supervise the banking system. The envisaged new institution would have fully independent status and be accountable to congress. The government is aware that careful planning is needed to ensure that bank supervision is not weakened during the transition to this new agency, and will study the desirability of unifying financial sector supervision under one regulatory body. A committee (consisting of representatives from the ministry of economy and production, the BCRA, and the other financial regulatory bodies) is to be established by December 2003 to move ahead with technical preparations for establishing the supervisory agency, and review means of improving the coordination of the work of the different regulatory bodies for the financial sector.

37. The government established earlier this year a Financial System Restructuring Unit (FSRU) to oversee the implementation of the strategy for those banks benefiting from extended central bank assistance. Implementing regulations are to be issued by September 2003 specifying the tasks of the unit, and the modalities under which decisions will be conveyed to the public. The Superintendency of Banks and the BCRA will remain responsible for implementation of the banking strategy.

Public bank reforms

38. The initial step in the reforms of public banks will be the completion of the ongoing due diligence examinations and strategic reviews of their future role. Bids to conduct this work for *Banco de la Nación* and *Banco de la Provincia de Buenos Aires* have been launched. In the case of *Banco de la Nación*, international firms to conduct the review will be selected by mid-November 2003, and the work of the consultants will be completed by June 2004. In the case of *Banco de la Provincia de Buenos Aires,* international firms will be selected by mid-February 2004 (structural benchmark for end-February, 2004) with the review work completed by August 2004. Based on the resulting recommendations, an agreed strategy will be developed for the public banking sector, identifying its role in financial intermediation and a detailed action plan for restructuring and strengthening of public banks. Preparation of this plan will be completed by September 2004, allowing implementation to begin soon thereafter. Regarding the third largest public bank, it is our intention to monitor its operations and adherence to regulatory standards through the Superintendency of Banks.

Strengthening the soundness of the banking system

39. A bill has been sent to congress to deal with the net effects of asymmetric indexation (CVS-CER) on the banking system, which has received approval by the House of Representatives and has been sent to the Senate where a fast approval (by end-September) is expected. The government will move rapidly to finalize this compensation, as well as the administrative decisions in order to fulfill the application of Article 6 of Law 25,561 of January 6, 2002 and Articles 28 and 29 of Decree 906 of May 31, 2002, by end-December 2003 (structural performance criteria). The government is closely monitoring the strength of the banking system and will assess the impact of the losses arising from judicial decisions. In the context of the first review of the program, the government will identify measures to assure the strength of the system for the benefit of depositors, borrowers, and banks.

40. A key program objective is to strengthen the banks and facilitate an increase in their lending. There are various measures that will help achieve these objectives, including: (i) the payment of market-related interest rates to encourage the rollover of government paper held by the banks; (ii) the planned phased reduction in the financial transactions tax; and (iii) reducing the high reserve requirement in the context of a prudent monetary policy. These policy measures will be complemented by banks' own efforts to (i) increase lending; (ii) reduce their high operating costs; and (iii) the speedy restructuring of private debt.

41. Temporary prudential rules were introduced in the first half of 2003 to provide time to financial institutions to adapt to post-crisis conditions. Requirements on minimum capital adequacy and valuation of government bonds and loans are to be phased in over the next few years. Rules on private loan classification, provisioning, and restructuring were eased temporarily, and this element of the forbearance will be removed as scheduled by end-December 2003 (structural performance criterion).

42. By October 2003, the BCRA will receive banks' financial statements for September 2003. These reports will be complemented for all banks by business plans and cash-flow projections that will include time-bound plans for full compliance with prudential regulations. The BCRA will review the adequacy of the business plans and cash flow projections. On the basis of audited end-2003 financial statements, the banks will be requested to submit updates of their business plans and cash flow projections, together with rehabilitation plans as needed, by March 2004. Following this, the BCRA will request the banks to submit semiannual updates of their business plans, monitor implementation of rehabilitation plans, and use its authority where necessary to resolve banks through some combination of mergers and acquisitions, or resolution under the Financial Institutions Law.

43. The banking strategy outlined above and the phasing of its implementation, will be further elaborated at the time of the first review of the program.

C. Ensuring Viable Utility Services

44. The government will act pursuant to the provisions of Law 25,561, Art. 9, which sets out the following principles for renegotiation of public utility and infrastructure concessions: utility contracts shall take the following criteria into account: (i) the impact of rates on economic competitiveness and income distribution; (ii) service quality and investment programs, where contractually agreed for; (iii) the interest of users, and service access conditions; (iv) system security; and (v) company profits. In this regard a new renegotiation commission was created, co-chaired by the ministry of economy and production and the ministry of planning and public works, and put in charge of the renegotiation of the 63 contracts in the areas of energy, transport, telecommunications, water, and postal services. The work in this area will be carried out in cooperation with the World Bank.

45. In July, the government submitted legislation to congress that: (i) extends the renegotiation period to end-2004; (ii) again gives the Executive Branch the power to renegotiate concessions via fast track; and (iii) allows the Executive Branch to implement renegotiation agreements which may cover partial aspects of concession or licence contracts, provide for contract adjustment or temporary amendment mechanisms, including the possibility of agreed periodic reviews, as well as to provide for an adjustment of service quality standards. In the case of temporary amendments, they must be taken into consideration under the terms of the final agreements to be reached with the concessionaire of licencee companies. Congressional approval of this law is expected by December 2003 (structural performance criterion).

D. Corporate Restructuring and Legal Reforms

46. The restructuring of corporate sector debt and a more predictable legal environment are essential complements to the banking strategy, and critical preconditions for sustaining the economic recovery. Corporate restructuring under the medium-term economic program will be effected under a voluntary, market-based framework that is driven by creditors and

debtors. In this process, no fiscal resources will be made available to support corporate debt restructuring. However, the government will play an important if limited role by:

- In collaboration with debtor and creditor groups, developing non-statutory workout principles embodying international best practices for use in restructuring negotiations; we expect that these principles will be made available for use by March 2004.

- Further reforms will be implemented as experience with debt restructuring identifies other regulatory impediments.

47. As a preliminary step, we intend to launch a detailed survey to clarify the financial condition of the corporate sector, including: (i) the extent of remaining foreign currency denominated indebtedness; (ii) overall corporate sector leverage ratios; and (iii) more generally, the impact of the post-convertibility macroeconomic environment on the financial condition and operations of firms. The timetable for the completion of this work will be set at the time of the first review.

48. An important component of our corporate restructuring strategy involves the adoption of targeted reforms to ensure that the insolvency law is capable of playing its important role in supporting out-of-court workouts. A working group on insolvency law reform has been formed to determine whether changes are needed to support corporate debt restructuring, and is expected to report by end-December 2003 (structural benchmark). Issues to be reviewed will include the need: (i) for improvements in the handling of insolvency cases in the court system; (ii) to make more effective the provisions governing court approval of "pre-packaged" restructuring agreements and bondholder voting on restructuring agreements; (iii) to reduce the substantial judicial and trustee (*síndico*) fees associated with insolvency petitions; (iv) to improve the effectiveness of creditors' committees; and (v) to make more effective the procedures for claims verification and enforcement of insolvency law judgments.

49. The 90-day statutory stay on mortgage foreclosures adopted during the period of the transitional stand-by arrangement expired on September 2, 2003. A 30-day standstill of similar scope has been granted on a voluntary basis by the banks' associations. We have completed a registration process designed to identify debtors that benefited from protection under the statutory stay, as well as creditors who were negatively affected by it. We intend to formulate by end-September 2003 alternative measures to assist poor debtors in this category, and will ensure that these fully respect creditor rights and also are consistent with existing fiscal constraints. This should remove the need for any further voluntary extensions.

50. The recently adopted exemption of media companies from the "cramdown" provision of the insolvency law remains in effect. By December 2003, we will review the need to limit the scope of this exemption to that necessary to give effect to the new limits on foreign ownership of media companies that were adopted in parallel with the cramdown exemption. This is an issue that is under consideration by the working group on amendments to the insolvency law described in paragraph 47 above. There will be no further sectors of the

economy exempted from the cramdown provision, and no statute or other legal instrument will be adopted during the period of the Stand-By Arrangement that provides a means for any involuntary suspension or other restraint of creditors' rights (continuous structural performance criterion).

51. The government recognizes that confidence in the rule of law and the protection of property rights has been adversely affected by the economic crisis. The creditor rights commitments summarized above are an important step in improving investor confidence and establishing a more predictable legal environment. Beyond these, we will examine the scope for broader reforms to ensure more legal predictability and contractual certainty in Argentina. A commission of eminent constitutional and legal experts will be established by end-2003 to examine the issue and make appropriate recommendations by June 2004.

V. Institutional Reforms

52. The government is committed to strengthen the transparency and effectiveness of the judicial system. In this regard, steps have been taken to improve citizen participation in the selection of judges by allowing civil and non-governmental organizations to screen and comment on the candidates proposed by the executive. In addition, the ministry of justice recently launched a program to improve the effectiveness and access to the judicial system through: (i) the shortening of the judiciary process, (ii) the geographical decentralization of the courts; (iii) the training of judicial personnel, and (iv) the intensification of legal audits.

VI. Anti-Money Laundering

53. Combating money laundering (AML) and the financing of terrorism (CFT) remain priorities of the government as part of its efforts to strengthen the rule of law and the integrity of the domestic financial system. As a member of the Financial Action Task Force (FATF), Argentina has been strongly supportive of international initiatives of this field, including the new AML/CFT methodology. Consistent with these initiatives, Argentina has agreed to participate in a FATF-led ROSC on these issues in the fourth quarter of 2003.

VII. Safeguards Assessment

54. The financial statements of the central bank will be prepared in accordance with International Accounting Standards for the year ending December 31, 2003, and the audited financial statements will continue to be published in a timely manner within four months of year-end. We also will continue to implement the Memorandum of Understanding with the ministry of economy and production on distribution of profits signed in July 2003.

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum sets out the specific quantitative performance criteria, indicative targets, structural performance criteria, and assumptions that will be applied under the Stand-By Arrangement.

I. FISCAL TARGETS

A. Federal Government

1. **Performance Criterion on the Cumulative Primary Balance of the Federal Government**

Cumulative Fiscal-Year Primary Balance of the Federal Government	Floor (In millions of Arg$)
End-June 2003 (for informational purposes)	4,930
End-October 2003	6,940
End-December 2003	7,790
End-March 2004	1,100
End-June 2004 (indicative target)	5,550
End-September 2004 (indicative target)	7,780
End-December 2004 (indicative target)	10,000

The primary balance of the federal government will cover government operations specified in the 2003 and 2004 budgets, and exclude privatization receipts and capital gains on the sale of financial assets. The primary balance of the federal government will be obtained from the accounts "*ahorro-inversión base caja*" published by the *Secretaría de Hacienda*. The primary balance of the federal government will incorporate transfers of realized central bank profits up to a maximum of Arg$950 million in 2003 and Arg$950 million in 2004.

Debt operations or any spending not registered above the line from July 2003 will be considered primary expenditure with the exception of those in points (i)-(vi) in Item 3 below, up to the amounts specified therein. Cash spending not included in "*ahorro-inversión base caja*" will be incorporated into primary expenditure.

To account for disbursements from the MDBs for projects, the 2004 targets will be adjusted upwards by the shortfall of the primary balances of provinces from program targets up to the amount of MDBs disbursement to provinces for primary spending. The adjustment will affect the subsequent target except for December 2004, when the adjustment will be concurrent.

These data will be provided to Fund staff by the *Secretaría de Hacienda* no later than 25 days after the test date.

2. Indicative Target on the Cumulative Overall Cash Balance of the Federal Government

Cumulative Fiscal-Year Cash Balance of the Federal Government	Floor (In millions of Arg$)
End-June 2003 (for informational purposes)	1,423
End-October 2003	600
End-December 2003	350
End-March 2004	-670
End-June 2004	2,130
End-September 2004	2,560
End-December 2004	3,150

The overall balance of the federal government comprises the results of the federal government and the quasi-fiscal balance of the central bank (BCRA). The coverage of the federal government is as specified in item 1 above. Interest excludes capitalization, arrears, and interest on debt currently nonperforming. The quasi-fiscal balance of the BCRA is defined as interest earnings on gross international reserves, plus interest on government bond holdings of the BCRA, plus net interest (cash) from domestic operations, and minus profit transfers to the federal government.

Debt operations and any spending not recorded above the line will be treated as explained in item 1 above.

The overall balance of the federal government will be measured from below-the-line on the basis of: (i) the information provided by the public sector debt reporting system (SIGADE), including all short-term debt of the federal government; (ii) net asset transactions of the federal government as reported by the *Secretaría de Finanzas*, the *Dirección Nacional de Cuentas Internacionales* (DNCI) and the *Gerencia de Manejo de Reservas Internacionales* of the BCRA; and (iii) information on federal government net bank borrowing and bank deposits provided by the BCRA.

These data will be provided to Fund staff no later than 25 days after the test date.

3. Performance Criterion on the Stock of Federal Government Debt

Federal Government Debt Stock	Ceiling (In billions of Arg$)
End-June 2003 (for informational purposes)	438
End-October 2003	520
End-December 2003	530
End-March 2004	540
End-June 2004 (indicative target)	550
End-September 2004 (indicative target)	560
End-December 2004 (indicative target)	570

The stock of debt is measured using the definition of the federal government in the 2003 and 2004 budgets. The program debt stock incorporates, among other things, the operation of the budget, the effect of inflation on debt indexed to the CER, interest arrears and interest on principal arrears[1] and the issuance of (i) compensation bonds to the financial system;[2] (ii) debt issued in the *Canje* deposit-bond exchanges (Arg$0.9 billion, September 2003), (iii) provincial government bonds arising from phase 1 debt exchange and guaranteed by the federal government (Arg$ 28.8 billion, September 2003), (iv) debt issued to depositors in connection with the lifting of the *corralón* (Arg$3.8 billion, September 2003), (v) debt issued in connection with the redemption of provincial quasi-monies (Arg$5.5 billion, September 2003), and (vi) debt recognition operations.[3]

For purposes of this performance criterion, the term "debt" has the meaning set forth in point No. 9 of the Executive Board's Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), which includes loans, leases, and suppliers' credits. The term "debt" also includes all obligations guaranteed by the federal government and contingent liabilities arising from derivatives contracts. Only debt actually placed by the test date will be included. Debt denominated in foreign currency will be valued at the program exchange rates, and peso-denominated debt will be valued using the program CER for the test date (see Section IV below). The following adjustments to the debt ceilings will be made in respect of transactions taking place after end-June 2003:

a. Downward for any privatization proceeds, other asset sales, debt restructuring or exchange, by the amount of any debt retired due to "netting" operations involving write-down of central bank liquidity support against bank holdings of government debt, and by the amount of any debt retired under the *Canje I*, *Canje II*, and *Cobertura* operations.

b. Upward (downward) for any increase (decrease) in the stock of debt resulting from deviations from the assumptions set out in points (i) to (iii) above.

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[1] Interest on principal arrears accumulates at 2 percent plus CER for peso-denominated debt and 8 percent for foreign currency denominated debt. The program debt stock does not include interest on interest arrears.

[2] These include: (a) the completion of the placement of the compensation bonds for asymmetric pesoization (Arg$8.6 billion, September 2003); and (b) compensation for asymmetric indexation of assets (Arg$3.8 billion, October 2003).

[3] These include bocones of Arg$1.4 billion spread evenly over July-December 2003, bocones of Arg$2.9 billion spread evenly over January-December 2004, and compensatory bonds to civil servants (Arg$1.9 billion, September 2003).

c. Upward (downward) for any net increase (decrease) in the stock of debt arising from deviations from the assumption of reversion of guaranteed loans issued in the phase 1 debt exchange to their underlying securities (Arg$17.1 billion, September 2003).

d. Upward (downward) for any increase (decrease) in the stock of debt resulting from deviations from the assumptions set out in point (iv) above.

e. Downward for any decrease in the stock of debt resulting from deviations from the assumptions set out in point (v) above.

f. Downward by any decrease in the stock of debt resulting from deviations from the assumption set out in point (vi) above.

The data used to monitor debt developments will be taken from SIGADE, including all short-term federal government debt. These data will be provided to Fund staff by the *Secretaría de Finanzas* no later than 25 days after the test date.

4. **Indicative Target on the Stock of Federal Government (*Administración Nacional*) Arrears (Floating Debt)**

Federal Government Stock of Arrears	**Ceiling (In billions of Arg$)**
End-June 2003 (for informational purposes)	5,971
End-October 2003	4,590
End-December 2003	5,000
End-March 2004	4,170
End-June 2004	5,070
End-September 2004	3,970
End-December 2004	4,660

The stock of arrears (floating debt) of the federal government is defined as the stock of accrued and not yet paid expenditures and includes arrears on VAT refunds to exporters. The federal government (Administracion Nacional) includes the central administration, the decentralized institutions, and the social security institutions included in the national budget.

The data will be reported to Fund staff by the *Secretaria de Hacienda* no later than 25 days after the test date.

B. Provincial Governments

5. Indicative Target on the Cumulative Primary Balance of the Provincial Governments

Cumulative Fiscal-Year Primary Balance of the Provincial Governments	Floor (In millions of Arg$)
End-June 2003 (for informational purposes)	1,556
End-December 2003	1,480
End-March 2004	180
End-June 2004	1,290
End-September 2004	2,230
End-December 2004	2,480

The primary balance of the provincial governments comprises the consolidated result of the provinces, including the Autonomous City of Buenos Aires. The result of these jurisdictions will be measured from above-the-line, with expenditure defined on a commitments basis[4] and including all spending that provincial governments pay with bonds (such as salaries paid with *Patacones*), according to the information provided by the *Secretaría de Hacienda*. These limits will be indicative.

These data will be provided to Fund staff by the *Secretaría de Hacienda* no later than 25 days after the test date.

C. Consolidated Public Sector

6. Indicative Target on the Stock of Debt of the Consolidated Public Sector (CPS)

The Debt Stock of the CPS	Ceiling (In billions of Arg$)
End-June 2003 (for informational purposes)	494
End-October 2003	542
End-December 2003	552
End-March 2004	563
End-June 2004	574
End-September 2004	584
End-December 2004	594

The stock of debt of the consolidated public sector includes the debt of the federal government as defined in item 3 above, that of the trust funds and PAMI, and that of the

[4] This excludes spending resulting from court judgments and spending incurred during past budget periods that had not been recognized previously.

provincial governments, and the city of Buenos Aires, net of intergovernmental debt, and including interest arrears. All the adjusters specified in item 3 above apply to these targets.

The data for the provinces, trust funds and PAMI will be provided to Fund staff by the *Secretaría de Hacienda* no later than 25 days after the test date.

II. Monetary Targets

7. Performance Criterion on Net International Reserves (NIR) of the BCRA

Net International Reserves	**Floor (In millions of U.S. dollars)**
End-August 2003 (stock, for informational purposes)	-4,049
End-October 2003	-4,500
End-December 2003	-4,400
End-March 2004	-4,350
End-June 2004 (indicative target)	-3,500
End-September 2004 (indicative target)	-3,300
End-December 2004 (indicative target)	-2,400

NIR is defined as the difference between gross international reserves and reserve liabilities. Gross international reserves are readily available[5] claims on nonresidents denominated in foreign convertible currencies and include the BCRA holdings of gold, SDRs, foreign currency in the form of cash, and deposits abroad, government securities of investment grade, Argentina's reserve position in the Fund and its net cash balances within the Latin American Trade Clearing System (ALADI). Reserve liabilities include all foreign currency denominated liabilities of the BCRA with original maturity of one year or less to residents and nonresidents, all liabilities to the Fund, and any net position on foreign exchange derivatives with both residents and nonresidents undertaken directly by the BCRA or by other financial institutions on behalf of the BCRA.

For the purpose of NIR calculations: (i) liabilities to the IMF are valued at US$1.3875 per SDR (see Section IV below); (ii) gross and net international reserves will be evaluated at program exchange rates (see Section IV below). NIR will be measured at the average value over the 10 working days preceding the test date and the 10 working days following the test date. On August 29, 2003, the NIR, thus defined, amounted to US$-4,049 million.

The following adjustments will be made to the NIR floor:

[5] All reserve assets that are pledged, frozen, or used as collateral, or otherwise encumbered will be excluded from reserve assets.

a. NIR floors will be adjusted by the cumulative amount of net amortization (i.e., principal payment minus new disbursements) from the World Bank and the IDB from September 1, 2003.

b. NIR floors will be adjusted downward by the amount of up front payments in foreign currency to creditors arising from the closing of the nonperforming public debt restructuring.

The adjusted NIR target will be measured on an average daily basis over the 10 working days preceding the test date and the 10 working days following the test date.

8. Indicative Target on the Augmented Monetary Base of the BCRA

Augmented Monetary Base	Ceiling (In millions of Arg$)
End-August 2003 (for informational purposes)	43,272
End-October 2003	44,305
End-December 2003	47,770
End-March 2004	46,260
End-June 2004	49,320
End-September 2004	49,625
End-December 2004	53,805

Augmented monetary base of the BCRA comprises the monetary base and the stock of provincial and federal government quasi-monies issued. Monetary base is defined as the sum of currency issued and banking system peso deposits with the central bank. The stock of quasi-monies will be measured at a value of 1:1 to the peso. The augmented monetary base will be measured at the average value over the 10 working days preceding the test date and the 10 working days following the test date.

9. Performance Criterion on Augmented Net Domestic Assets (NDA) of the BCRA

Augmented Net Domestic Assets	Ceiling (In millions of Arg$)
End-August 2003 (for informational purposes)	55,014
End-October 2003	57,355
End-December 2003	60,530
End-March 2004	58,875
End-June 2004 (indicative target)	59,470
End-September 2004 (indicative target)	59,195
End-December 2004 (indicative target)	60,765

The augmented net domestic assets (NDA) of the BCRA are defined as the difference between augmented monetary base and net international reserves (NIR) of the BCRA.

The ceilings on the augmented NDA will be subject to the adjustors applying to the NIR floor, as described in item 7 a. and b., but with the opposite sign.

10. **Consultation Mechanism on the 12-month Rate of Inflation**

Inflation prospects will be an important part of each review under the arrangement. During the period December 2003-September 2004, should the 12-month rate of inflation in consumer prices projected for end-2004 deviate from the 7-11 percent range, the authorities will discuss with Fund management the appropriate policy response.

III. Continuous and Structural Performance Criteria and Benchmarks

Continuous performance criteria, structural performance criteria, and structural benchmarks under the program are detailed in the MEFP. In addition, consistent with the financial framework specified in paragraphs 7 and 8 of the MEFP, the non-accumulation of arrears to bilateral and multilateral creditors will be a continuous performance criterion under the program. The following definitions will apply:

a. **Legislative approval of tax administration reform package (structural performance criterion, end-November, 2003).** The approval of the following legislative proposals is required: changes to the tax administration procedures law providing new instruments and penalties to reduce tax evasion and elusion (Expte. 42 PEN: Mensaje 207). Moreover, legislative approval of three of the following four legislative proposals is required: (i) income tax law: strengthen the legislation with respect to international operations (Expte. 45 PEN: Mensaje 221); (ii) tax penal law: creation of the legal concept of illicit association with the intent to defraud (Expte. 41 PEN: Mensaje 208); (iii) creation of federal jurisdiction for tax tribunals in the city of Buenos Aires; and (Expte. 43 PEN: Mensaje 209); and (iv) strengthen the small taxpayer regime (Expte. 40 PEN: Mensaje 210).

b. **Ratification of bilateral agreements (structural performance criterion, end-March 2004).** Bilateral agreements will have to be ratified or become legally valid in provinces representing at least 100 percent of the 2002 consolidated provincial deficit.

c. **Formal agreement on the objectives of intergovernmental reform and fiscal responsibility legislation (structural performance criterion, end-March 2004).** The agreement will need to specify the outline of intergovernmental reform with respect to the primary and secondary distributions, strengthening of provincial revenue capabilities, and the creation of fiscal federalism institutions. The outline of fiscal responsibility legislation should be specified for debt and deficit limits, procedures for approval of provincial borrowing, and incentives for compliance with the legislation. The agreement will have to be reached with at least 20 governors representing at least 90 percent of Argentina's population.

d. **Elimination of the stock of VAT arrears (structural benchmark, end-March 2004).** For the conditionality on eliminating the stock of VAT arrears, a normal level of VAT refund arrears will be considered to include: (i) refund claims under investigation in the

BCRA (about Arg$290 million) and (ii) claims whose payment has been delayed by up to 30 days (about Arg$220 million).

e. **Continuous structural benchmark on below the line reporting.** The Secretaría de Hacienda and the BCRA will provide the following data from below-the-line on the financing flows of the provinces no later than 55 days after the end of the test date. The data will comprise provincial government deposit changes including quasi-monies, issuance of provincial bonds, the issuance of any other form of provincial debt (including debt service arrears), privatization receipts and amortization of provincial debt.

IV. Program Accounting Rates

Arg$/US$1 (e.o.p)	2.9
US$/SDR (e.o.p.)	1.3875
US$/Euro	0.869
US$/CAD$	1.347
US$/JPY	119.78
US$/CHF	1.351
US$/GBP	0.604
Gold ($ per ounce)	371.0

The following CER path will be used for program purposes:

	Oct. 2003	Dec. 2003	Mar. 2004
CER coefficient (e.o.p)	1.492	1.518	1.557

Any variable that is mentioned herein for the purpose of monitoring a performance criterion or indicative target and that is not explicitly defined, is defined in accordance with the Fund's standard statistical methodology, such as the Government Financial Statistics. For variables that are omitted from the TMU but that are relevant for program targets, the authorities of Argentina shall consult with the staff on the appropriate treatment based on the Fund's standard statistical methodology and program purposes.