

I. ECONOMIC ENVIRONMENT

(1) INTRODUCTION

1. During the 1990s, Argentina has continued the economic reform and restructuring process initiated in 1989 and deepened in 1991 with the adoption of the Convertibility Plan.¹ The reforms have achieved notable success in the macroeconomy; GDP growth averaged 5.3% over the period 1990-1997 despite a sharp slowdown in 1995 following the Mexican financial crisis; GDP per capita has doubled; and price inflation, previously a serious problem, has been reduced to levels comparable to or below OECD averages under the monetary discipline of the currency-board system and associated macroeconomic measures. This greater economic stability, combined with domestic structural reforms and the increasing integration of MERCOSUR, have encouraged foreign investment, stimulating changes in the structure of production and trade. The adjustment process has not, however, been without economic and social costs: recorded unemployment and under-employment have risen sharply and poverty has increased, although there appears to have been some improvement since 1996. Official projections imply a slight deceleration of the economy in 1998 with recovery, mainly supply-driven, by 2000; however, these estimates depend heavily on the impact of the Asian financial crisis on Argentina's trade and the pace of growth in the MERCOSUR economies, mainly Brazil.

(2) RECENT ECONOMIC DEVELOPMENTS

(i) Growth, incomes and employment

2. Following a period of robust economic growth in 1991-94, with average annual GDP growth of 8.9%, the Argentine economy contracted sharply, by 4.6%, in 1995 (Table I.1), largely due to the impact of the 1994 Mexican financial crisis (Box I.1).² Before the recession, growth had been mainly driven by investment, fuelled by inflows of foreign capital, as well as by demand for motor vehicles, construction and other services, notably financial and commercial services. Since 1996, the economy has recovered as a result of growing domestic and foreign demand, as well as higher world prices for commodity exports (prices for grains and dairy products reached near-record levels in mid-1996). Growth recovered from 4.3% in 1996 to over 8% in 1997, despite declining terms of trade in that year; the recovery was strongest in energy, construction, finance, and manufacturing, especially textiles and motor vehicles. Recent projections indicate a deceleration of real GDP growth in 1998 to 5%, a possible outcome of the expected slowdown in the growth of world trade caused by the Asian financial crisis. However, a supply-led recovery is projected by the year 2000.³

3. Reflecting market-opening measures, the ratio of Argentina's trade in goods and non-factor services to GDP increased from 20% in 1991 to about 32% in 1996 (Chart I.1). The authorities attribute these relatively low levels to a high degree of self-sufficiency, mainly in food, energy and

¹ As described in GATT (1992), the Convertibility Plan involved five areas of policy initiatives or regime shifts (domestic currency convertibility, trade liberalization, deregulation, privatization, and reform of the financial system) which improved the supply conditions of the economy.

² World Bank (1996a); EIU (1997a), p. 18; IMF Press Release No. 98/1, 4 February 1998; IMF Press Information Notice (PIN) No. 98/9, 23 February 1998. Domestic consumption represents 70%-80% of the GDP.

³ IMF Press Release No. 98/1, 4 February 1998.

natural resources; Argentina's size and geographical location; and a production pattern which is a legacy of past import-substitution industrialization (ISI) strategies.⁴

Table I.1
Economic developments, 1990-97

	1990	1991	1992	1993	1994	1995	1996	1997
	Average annual growth rate, %							
Real GDP	-1.3	10.5	10.3	6.3	8.5	-4.6	4.3	8.2
Consumption	-1.1	14.3	13.3	5.7	6.9	-6.1	5.3	7.7
Gross domestic investment	-15.2	31.5	33.5	16	21.8	-16.3	8.3	27.1
Exports of goods and services	16.8	-5.1	2.1	2.4	15.9	22.7	6.5	7.7
Imports of goods and services	-0.7	75.6	66.5	13.4	22.5	-11.6	16.8	27.2
Inflation (end of period CPI)	1,344.4	84	17.5	7.4	3.9	1.6	0.1	0.3
Unemployment rate (%)	8.6	6.9	6.9	9.9	10.7	18.4	17.1	13.7 ^a
Memorandum:								
Population (million)	32.6	33.0	33.4	33.9	34.3	34.8	35.2	..
GDP/capita (US\$ current prices)	4,342.6	5,743.1	6,851.9	7,612.7	8,214.6	8,041.8	8,445.8	..
Non-financial public sector finances								
Overall balance (<i>resultado global</i>) (US\$ billion) ^b	..	..	1.4	2.7	-0.3	-1.3	-5.3	..
Overall balance (% of GDP)	..	..	0.6	1.1	-0.1	-0.5	-1.8	..

.. Not available.

a As of October 1997.

b Overall balance represents the difference between total revenue (i.e. current revenue plus capital) and total expenditure (i.e. current expenditure plus capital expenditure).

Note: Average annual growth is calculated using 1986 constant prices.

Source: MEOSP (1997), *Informe Económico No. 21 - Primer Trimestre de 1997*; MEOSP (1994), *Informe Económico Año 1994*; International Monetary Fund, IFS, various issues; and World Bank, *World Development Indicators*; MEOSP (1998), *Informe de Avance del Nivel de Actividad*, March.

4. Since 1990 the share of services in GDP has increased from 62.8% to 65.4% (1996), while the shares of agriculture, livestock and manufacturing have declined slightly (Table I.2). On the other hand, the share of employment in agriculture has almost doubled in recent years. Economic activity remains unevenly distributed, with less than one fifth of the territory (the Federal District of Buenos Aires and the Provinces of Córdoba and Santa Fe) providing 80% of industrial and 92% of agricultural output. Following public sector reforms in recent years, employment by the federal administration fell by about 58% between 1990 and 1996, to 284,000 (Box I.2).

5. GDP per capita has doubled since 1990, reaching an estimated US\$8,446 in 1996, after a decline in 1995 (Table I.1). The overall level of human development in Argentina remains the highest in Latin America, with high literacy rates and enrolment in primary and secondary education. A falling birth-rate and increasing life expectancy (currently 73 years) is leading to an ageing population, prompting a need for pension reform. Health care is shared between the public and the private sectors and semi-public mandatory health trust funds linked to places of employment; health insurance schemes cover 80% of the population while the funds' services cover 65%.

⁴ Study by the Secretariat of International Economic Relations of the Ministry of External Relations, International Trade and Worship cited in *La Nación Line*, 18 June 1997.

Box I.1: Facing exogenous crises with a currency board

Since the previous Trade Policy Review, Argentina has had to cope with two major exogenous crises induced by currency devaluations by major trading nations.

The crisis of confidence provoked by the Mexican financial crisis at the end of 1994 caused a sharp, one-year recession. Domestic demand and fixed investment contracted; production declined; unemployment increased sharply; and there were shortfalls in tax revenues and strains on the financial system. This first severe test of the Convertibility Plan highlighted the extent of the economy's reliance on volatile capital flows, the weakness of the financial system and the difficulties in holding the nominal exchange rate during periods of crisis. That the Plan survived was thanks to strict macroeconomic discipline, which maintained the credibility of the programme. Furthermore, a devaluation under crisis conditions in a highly dollarized economy would probably have been highly counterproductive, deepening the crisis it was intended to correct.

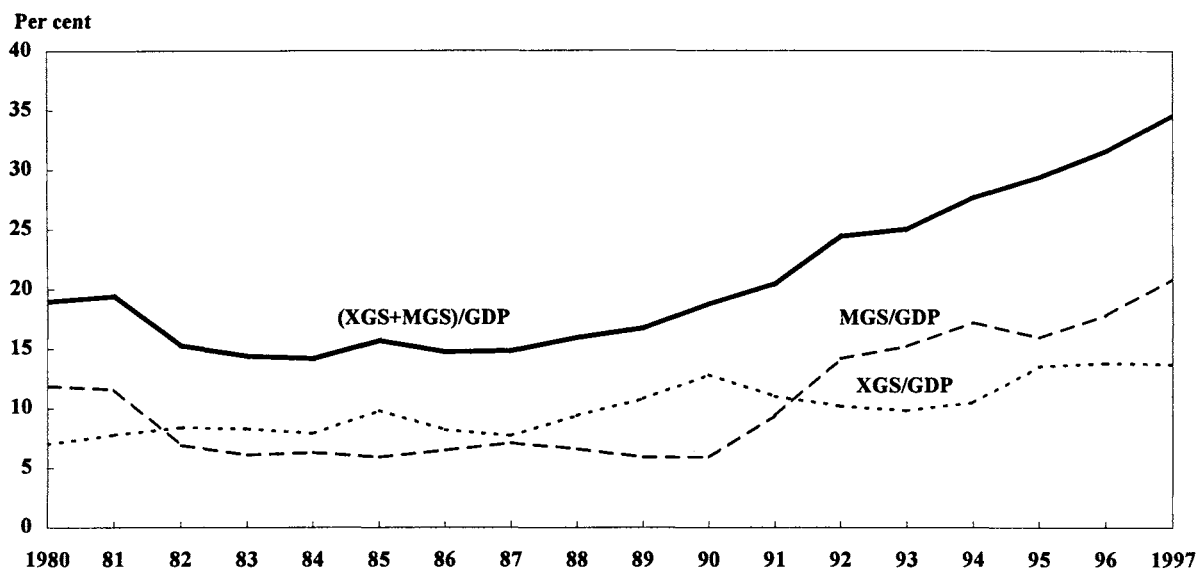
The fast recovery from the Mexican crisis was largely due to a forceful government response, mainly in the fiscal and financial areas. The impact of the shock was moderated by strong trade performance, linked to the introduction of the Real Plan in Brazil and bilateral trade arrangements with that country. Pressure to reverse previous liberalization was resisted. The crisis made a significant restructuring in the financial sector necessary, as well as an improvement of competitiveness in other sectors by cutting costs and improving productivity.

Initial concerns about the impact of the Asian crisis of 1997/98 were based on the facts that Argentina's external debt was among the highest in the region and that short-term external debt was roughly comparable to international reserves. Argentina was also seen as vulnerable to any short-term portfolio shift that might be triggered by higher U.S. interest rates. Despite concern over the possibility of a speculative attack on the peso, by December 1997 the markets were displaying confidence in the operation of the quasi-currency board system in Argentina because of the backing of the monetary base with international reserves.

By early 1998 the Asian crisis was starting to have some direct and indirect trade effects on Argentina: in the first quarter of 1998 exports to ASEAN markets dropped by 41% (mainly agricultural items) while imports grew by 22%, (mainly consumer and capital goods), reversing the previous year's trade surplus with the region. The most affected manufacturing sectors were: motor vehicles, where orders from Brazil have fallen; man-made fibres, where domestic production was cut both in Argentina and Brazil as a result of increased imports from South-East Asia; other textiles, where prices quoted by Asian suppliers fell by 35% over the last months of 1997; footwear, where Argentine imports from Asia have increased; and, to a lesser extent, oil and agricultural items, where Argentine maize sales to Asia have started to drop.

So far, Argentina has weathered the latest turbulence in world capital markets well and there have not been any major immediate consequences in the economy. The Government response has so far been to emphasize the solidity of Argentina's banking and financial system. A second response to the crisis has come at MERCOSUR level with the across-the-board increase of the CET by 3 percentage points in 1998 (Chapters II and III); which was also prompted, inter alia, by the deterioration of Brazil's current account and budget deficit. By December 1997, the authorities were minimizing the threat because of the low share of trade with Asia. In addition, confidence has been expressed in the efficacy of WTO-compatible contingency measures against imports.

Chart I.1
Trade in goods and non-factor services, 1980-97



Source: MEOSP (1997a), *Informe Económico No. 21 Primer Trimestre 1997*; MEOSP (1997b), *Informe Económico No. 22, Segundo Trimestre 1997*; MEOSP (1998), *Informe de Avance del Nivel de Actividad*, March.

Table I.2
Structure of the economy, 1990-97

	1990	1991	1992	1993	1994	1995	1996	1997
Share of main sectors in GDP (%)								
Agriculture, livestock and fishing	8.8	8.3	7.5	7.2	6.9	7.4	7.2	6.7
Mining and quarrying	2.5	2.4	2.4	2.5	2.5	2.8	2.9	..
Manufacturing	25.9	25.7	25.7	25.4	24.9	24.3	24.5	24.9
Services	62.8	63.6	64.4	64.8	65.7	65.5	65.4	..
of which:								
Commerce, restaurants and hotels	15.7	16.4	17.0	16.6	16.6	16.0	..	..
Finance, insurance, real estate, and business	15.0	16.0	16.6	17.0	17.7	17.5	..	..
Construction	4.6	5.2	5.5	5.7	6.1	5.7	5.5	6.1
Transportation and communication	4.9	4.9	5.1	5.0	5.1	5.3	..	..
Electricity, gas and water	2.1	2.0	2.0	2.0	2.0	2.3	2.5	..
Other services	20.5	19.1	18.4	18.4	18.2	18.7	..	..
Share of sectors in total employment (%)								
Agriculture, livestock, fisheries	..	..	..	..	3.4	3.5	6.0	6.1
Manufacturing	..	..	..	..	26.5	26.0	24.1	23.3
Services	..	..	..	..	70.1	70.5	69.9	70.6
Construction	..	..	..	..	5.8	5.3	5.7	5.7

Not available.

Source: Data provided by the authorities of Argentina.

Box I.2: Privatization, deregulation and public sector reforms

A large and inefficient public sector was widely seen as one major reason for Argentina's disappointing economic performance in the post-war period. However, attempts at reform were limited and subject to strong congressional opposition. By 1989 federal public enterprises were generating large operating deficits as a result of overstaffing, procurement from overprotected domestic industries, and the operation of a number of uneconomic activities. Inadequate investment led to severe shortages, obsolete technology and poor service.

Argentina's aggressive and ambitious privatization programme was aimed at easing the stance of the public sector in the short term by generating new cash flows, debt reduction and lower spending, and, in the medium-to long-term, at obliging the firms to become more competitive and increasing the volume and efficiency of new investment. The process was assisted by several World Bank adjustment loans (totalling US\$1.5 billion) as well as a US\$23 million technical assistance loan (Public Enterprise Reform Execution Loan, PEREL); the first loan (Public Enterprise Reform and Adjustment Loan I, PERAL I), proposed, inter alia, repealing legislation that required public enterprises to favour domestic suppliers.

Within three years (1991-94) about 90% of State enterprises were privatized for the equivalent of more than US\$20 billion, most of which was used for debt reduction; by 1996, most public utilities (telecommunications, airlines, power generation and distribution, gas transportation and distribution, and passenger and cargo railways) and all productive facilities (including oil and gas extraction, coal mining, petrochemical plants, and steel mills) had been transferred to the private sector. The National Mortgage Bank (Banco Hipotecario Nacional), the Argentine National Bank (Banco de la Nación Argentina), the post office, the airports network and nuclear power stations are to follow in 1998. Privatization of banks, electricity generation and distribution, and water and sewerage systems at provincial level was speeded up in 1995 but has been uneven so far; the privatization of remaining provincial banks appears important for the strengthening of the financial system as well as to improve allocative efficiency and fiscal discipline.

Argentina's substantial and exceptional results in restructuring and privatizing were mainly due to the strong government commitment and rapid action, short-circuiting any opposition. Although the immediate beneficiaries were taxpayers and investors, gains to consumers should become more apparent as competition takes hold. As a complement to privatization, the deregulation of the economy (e.g. in ports, public utilities, transport, oil and gas) through the abolition of price controls and the closing down of regulatory and marketing bodies and boards, has led to cost reductions in production, shipping and transportation as well as improved availability of several public utilities (gas, water, electricity, telecommunications).

The reform of the federal bureaucracy also began in 1990. Based on a ministerial reorganization and improvements in the civil service system, this exercise enabled the Government to increase average salaries and partially restore salary differentials. Federal employment decreased from 671,000 to 284,000; out of the 387,000 job cuts, 103,000 were layoffs and 284,000 were transfers of teachers and health workers to the provinces.

6. Despite the creation of 884,500 jobs since 1991, efforts to reduce labour costs, and further liberalization of the labour market, in recent years unemployment and under-employment have become serious concerns. Between 1992 and 1995, recorded unemployment increased from 6.9% to 18.4%, firstly as a consequence of structural reforms and secondly due to the sharp recession that followed the 1994 Mexican crisis. Underemployment (defined as workers employed for less than 35 hours) rose from 8.9% to 13.6% in the same period.⁵ Following years of steady decline, since 1995 poverty indices have risen as a result of growing unemployment and the limited reach of the social safety net; in 1996, the percentage of families living below the poverty line was estimated

⁵ Private observers' estimates were more than double (Study by the Argentine Centre for Macroeconomic Studies (CEMA) cited in Latin American Regional Reports - Southern Cone, 27 December 1996). Data from Ministry of Economy, National Accounts Office.

to have risen to 20% from 14% in 1994 (Box I.3). Since 1996, there has been some decrease in unemployment, to an estimated 13.7% in October 1997, mainly caused by a sharp increase in new urban jobs, including temporary (fixed-term and "trial") posts⁶; the rate of underemployment has stabilized. Consequently, the share of families below the poverty line also fell slightly, to 18.8% in May 1997.

Box I.3: Policy challenges and plans

In recent years Argentina has made substantial progress in structural reforms such as re-defining the role of the State, privatization, pension reform, etc. The principal policy challenges facing the country in the next few years cover areas such as: taxation, health, education, the labour market, poverty alleviation, and the judicial system.

Labour market reforms are important for promoting longer-term economic growth, a reduction in unemployment and continued external competitiveness. However, despite new legislation to increase labour flexibility for small and medium-sized enterprises, rigidities persist. The authorities are committed to the early passage of a reform package to enhance labour market flexibility and improve wages; this seeks to achieve a significant reduction in dismissal costs and progressive elimination of the "ultra-actividad" clause (where employment contracts remain legally binding after their expiry if there is no agreement between unions and employers to renegotiate).

In relation to poverty alleviation, the Government is to pursue efforts to restructure social programmes to improve the targeting of vulnerable groups. In addition to programmes providing health care, food, assistance and schooling, low-cost housing is to be provided for at least 50,000 families a year and basic infrastructure is to be made available for the 1,000 poorest municipalities in the country. Initiatives in health care are to include a revision of the regulatory framework for private health care providers and completion of the restructuring of the health insurance system for retirees and of health organizations run by unions.

Reforms of the judicial system are aimed at improving its efficiency, especially in areas of macroeconomic relevance such as tax evasion and public ethics. Judicial procedures are to be modified so as to speed up the resolution of tax cases and increase legal security in credit markets. Public ethics have been subject to increased debate in Argentina, and a decrease in corruption and fraud cases has followed the privatization of most State enterprises.

(ii) Prices

7. Following the introduction of the Convertibility Law in 1991, together with efforts to reduce federal expenditures and raise tax revenues, and the elimination of indexation, price inflation fell from over 1,300% in 1990 to an estimated 0.1% in 1996, the lowest rate recorded in 58 years and among the lowest in the world (Table I.1). This has been a major accomplishment, given Argentina's history of bursts of hyperinflation. Inflation rose slightly to 0.3% in 1997 and is expected to be approximately 1% in 1998.

(iii) Public finances

8. There have been marked improvements in Argentina's public finances since the previous Review, despite a setback following the Mexican financial crisis. While privatization and restructuring of the public sector form the basis of the programme (Box I.3), there have also been important tax reforms, spending cuts and a restructuring of liabilities.

⁶ The authorities estimate that since 1996 about 600,000 new jobs have been created each year (MEOSP (1998a)).

9. Following the initiation of reform in 1991, the public accounts experienced a period of modest surpluses (Table I.1). This was the result of more efficient tax collection, increased tariff revenue resulting from the import surge, and large infusions of revenue from privatization. However, as privatization receipts fell off, deficits reappeared, increasing substantially in the wake of the Mexican financial crisis, as a consequence of growth in public spending, certain structural reform measures, and a drop in revenue as consumer spending fell. The overall balance of the non-financial public sector moved to a deficit of 0.1% of GDP in 1994, rising to 1.8% in 1996. However, following improvements in the fiscal stance, this ratio dropped to 1.3% in 1997⁷, and further reductions are expected in 1998 under a comprehensive tax reform aimed at: further improving the efficiency and equity of the tax system; broadening the bases of income tax and VAT, for example, by covering imports and exports of services and suppressing exemptions; and modifying excise taxes. Under the programme, agreed in the context of the extended arrangement with the IMF (below), the overall public sector deficit is to be reduced to under 0.5% of GDP by the year 2000, with further reforms in taxation, fiscal relations with provincial governments, and the social security system.

10. Under fiscal pressure, costly incentives have been largely eliminated. There has also been substantial reform of the tax system and administration. However, in response to movements in the fiscal situation there have been a number of abrupt changes – increases and decreases – in certain tariff rates, and in the level of the statistical tax (Chapter III), giving the impression of a degree of instability in the level of protection.

11. Among the measures to raise revenue collection and streamline the tax system were the introduction of a uniform VAT, with a broad base; subsequent increases in the rate of VAT; increased rates of excise tax on fuels (particularly diesel) and new diesel-powered motor vehicles, income tax for high-income individuals and corporations, and social security taxes for the self-employed; the removal of 21 minor and inefficient taxes (e.g. the gas-oil and federal stamp taxes, charges on bank debt, freight, shipping, and foreign currency transactions, and certain export taxes); the implementation ahead of schedule of the MERCOSUR Common External Tariff on certain capital goods; and a 1996 tax moratorium expected to generate a flow of US\$4 billion of revenues over the following 30 to 35 months. Efforts to reduce public expenditure were focused on suppression, under the Convertibility Law, of the tax adjustment for inflation purposes and the elimination or reduction of certain tax incentives such as drawbacks for exports, incentives linked to sale of domestically produced capital goods, and the industrial specialization regime. The efficiency of tax administration was increased by establishing a verification system for the largest taxpayers and introducing institutional changes concerning tax collection (Chapter II). Further action was taken by passing a penalty law against tax non-compliance, increasing penalties for tax evasion, and launching a campaign against corruption.

(iv) Exchange rate developments and the money supply

12. Since April 1991, the fixed exchange rate of one peso to one United States dollar, established under and guaranteed by the Convertibility Law, has been maintained; it may be modified only by law. Access to foreign exchange is unrestricted and no exchange controls are operated.

13. The Central Bank of Argentina (BCRA) controls the money supply by buying and selling United States dollars at the fixed rate. Under the Convertibility Law, Argentina's monetary base may

⁷ According to the IMF, the overall public sector deficit has since been progressively reduced, from 3.4% of GDP in 1995 to 1.9% in 1997 (IMF estimates contained in IMF Press Information Notice (PIN) No. 98/9, 23 February 1998).

not exceed its international reserves (with some limited flexibility), thereby effectively converting the Central Bank into a currency board.⁸ Following the Mexican financial crisis of 1994/95, the Central Bank used its flexibility to reduce the foreign-exchange backing of the monetary base from close to 100% to a minimum of 80%; however, the authorities have indicated that at present this ratio exceeds 100%, a sign of confidence in the system.

14. The fixed exchange rate, and the release of pent-up demand stemming from the overall economic recovery have made imports increasingly competitive. Certainly, at the outset of the Convertibility Plan, the divergence between domestic and the U.S. inflation rates contributed to a rapid real appreciation of the peso (Chart I.2). However, between 1992 and 1994 the appreciation was partly compensated by measures such as market deregulation, removal of distortive taxes and reduction of social security contributions, designed to reduce domestic production costs, the so-called "Argentine cost" (*costo argentino*). Moreover, since 1994, the rate of inflation has fallen rapidly towards OECD rates, and in 1996-97 was lower than in the United States. Exports within the region have become more competitive because of the real appreciation of the Brazilian currency in the same period.⁹ Up to late 1996, competitiveness also benefited from the depreciation of the U.S. dollar against European currencies and the yen, but this has been reversed in the last 18 months.

15. Under MERCOSUR, Argentina's trade and overall economic prospects have become closely tied to macroeconomic stability and sustainable economic growth in Brazil. Given Argentina's fixed exchange rate regime against the U.S. dollar, should Brazil's currency experience real depreciation, Argentina's exports may suffer and imports further increase. The elimination of imperfections in the financial and labour markets and export diversification could reduce such risks.

(v) Balance of payments

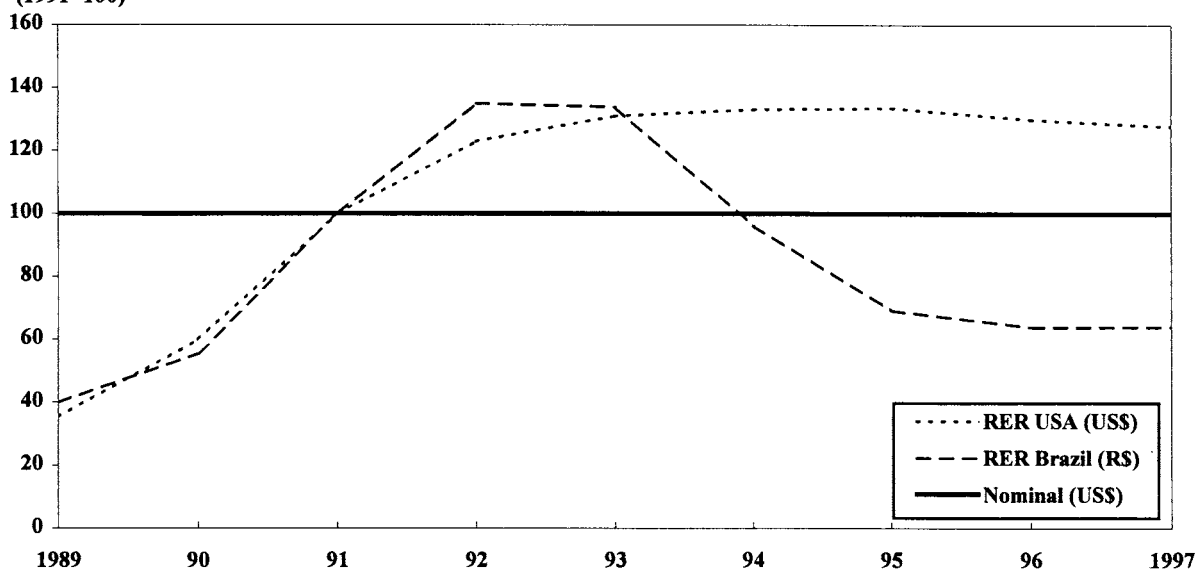
16. Since 1992, Argentina has experienced a series of current account deficits, financed largely by growing external long-term borrowing, foreign direct investment inflows and privatization receipts (Table I.3). Up to 1994, the current account imbalance was driven by a growing merchandise trade deficit and steadily rising net investment outflows on interest and profits. The peak in the current account deficit in 1994 stemmed from a surge in imports, linked, *inter alia*, to Brazilian depreciation prior to the Real Plan, and increased interest payments resulting from rising U.S. interest rates. On the other hand, since 1992 interest earnings have more than doubled, also because of high interest rates. The move from deficit to surplus in merchandise trade in 1995 and 1996 was linked to Argentina's real depreciation *vis-à-vis* Brazil, in particular, as well as import compression in 1995 resulting from the contraction in demand following the Mexican financial crisis. In 1997, a trade deficit reappeared as a result of import growth; in response to IMF concerns, the authorities explained that such growth was mainly due to imports of capital goods, which are expected to generate future exports.

⁸ Some flexibility derives from the discretion the Central Bank has in the use of variable bank reserve requirements and excess international reserves (World Bank, 1996a).

⁹ The Argentina-Brazil Automotive Agreement has also helped automotive exports to Brazil, but this regime is to be terminated by the year 2000 (Chapter IV).

Chart I.2

Indices of real (RER) and nominal exchange rates, 1989-97

Foreign currency per peso
(1991=100)

Note: Exchange rate (April 1991=1) deflated by the CPI.

Source: MEOSP (1998), *Informe Económico No. 24*.

17. The sharp fall in net capital inflows to US\$2.7 billion in 1995 also reflected the loss of investors' confidence in Latin America at large following the Mexican financial crisis (Table I.3). However, it is difficult to give precise details about the decline in new investment or the extent of capital flight as the change is mainly registered under "other capital" (errors and omissions). Net inflows recovered to US\$7.6 billion in 1996 and in 1997 reached a record US\$13.2 billion, demonstrating renewed confidence in the economy.

18. Since 1990, movements in the growth of Argentina's international reserves have mainly reflected rising foreign exchange earnings from exports, as well as foreign direct investment and external long-term borrowing inflows (Table I.3). In 1995, the BCRA lost more than one third of its liquid reserves. However, by April 1998 international reserves had recovered to reach a level of US\$23.2 billion, equivalent to about eight months of imports of goods and services.

19. In the light of the external debt servicing requirements, discussed below, the growing regional concentration of exports and the subsequent vulnerability to changes in regional market conditions, the IMF Executive Board has recently welcomed the authorities' commitment to take quick, decisive action to restrain domestic demand should the current account deteriorate further or prospects for external financing worsen.¹⁰

¹⁰ IMF Executive Board Assessment of the 1997 Article IV consultation with Argentina contained in IMF Press Information Notice (PIN) No. 98/9, 23 February 1998.

Table I.3
Balance-of-payments, 1990-97
(US\$ million)

	1990 ^a	1991 ^a	1992 ^b	1993 ^b	1994 ^b	1995 ^b	1996 ^b	1997 ^b
Current account balance	6,431	1,047	-5,462	-7,672	-10,117	-2,768	-3,787	-10,119
Merchandise trade balance	8,275	3,703	-1,450	-2,426	-4,238	2,238	1,622	-3,195
Exports (f.o.b.)	12,354	11,978	12,235	13,117	15,839	20,964	23,811	25,223
Imports (f.o.b.)	4,079	8,275	13,685	15,543	20,077	18,726	22,189	28,418
Non-factor services	-284	-815	-2,257	-2,730	-2,941	-2,222	-2,495	-3,069
Exports	2,681	2,762	2,454	2,454	2,599	2,860	3,226	3,271
Imports	2,965	3,577	4,711	5,184	5,540	5,082	5,721	6,340
Investment income	-2,114	-2,070	-2,416	-2,927	-3,258	-3,216	-3,248	-4,205
Interest balance	3,075	2,745	-1,289	-1,081	-1,136	-1,054	-1,326	-1,770
Interest earnings	5,189	4,815	2,099	2,135	3,073	4,348	4,587	5,332
Interest payments	444	564	3,388	3,216	4,209	5,402	5,913	7,102
Profits and dividends	-2,714	833	-1,127	-1,846	-2,122	-2,162	-1,922	-2,435
Transfers (net)	..	..	661	411	320	432	334	350
Capital and financial account balance	..	..	8,567	12,152	10,678	2,699	7,569	13,181
Banking sector	..	..	826	-1,527	1,893	4,360	-519	-1,794
Central Bank (BCRA)	..	..	-177	-2,818	307	1,929	849	-800
Other financial entities	..	..	1,003	1,291	1,586	2,431	-1,368	-994
Non-financial public sector	..	..	1,285	7,121	4,097	5,945	8,731	7,331
National government	..	..	1,853	6,473	4,471	6,435	8,583	6,495
Local government	..	..	31	889	189	374	612	1,231
Public enterprises and other	..	..	-599	-241	-563	-864	-464	-395
Non-financial private sector	..	..	2,766	4,559	4,454	4,923	5,415	9,035
Other Capital ^c	..	..	3,690	1,999	234	-12,529	-6,058	-1,391
Changes in international reserves^d	3,717	1,880	-3,105	-4,480	-561	69	-3,782	-3,062
Memorandum:								
Current account balance/GDP (%)	9.33	0.58	-2.41	-2.98	-3.59	-0.99	-1.27	..

.. Not available.

a Data for these years based on MEOSP (1994, Table A.5.6 (*Versión "Argentina en crecimiento"*)).

b Preliminary estimates.

c Includes errors and omissions.

d Negative = increase.

Source: Data provided by the authorities of Argentina; and International Monetary Fund, IFS, February 1998.

(vi) External debt

20. Between 1991 and 1997 Argentina's external debt rose by more than 86% in value to US\$109.4 billion (Table I.4), increasing pressure on fiscal accounts and turning external finance into a key condition of economic growth. Nevertheless, with rapid GDP growth, the external public debt/GDP ratio has only risen slightly in recent years, growing from 23.4% in 1993 to 26.3% in 1998. Argentina has had no difficulty in obtaining needed external financing so far, although it remains vulnerable to changes in external market conditions.¹¹

21. The restructuring of external debt in 1992 enabled banking institutions to regain access to international capital markets, allowing them to provide longer-term funding. In 1997, the non-financial public sector was responsible for about 69% of external debt, a much lower share than in 1991, mainly as a result of the privatization programme. Reflecting the same shifts, foreign borrowing by the private non-financial and financial sectors has also increased substantially in recent years.¹² While the share of lending by the international financial institutions has remained steady,

¹¹ IMF Press Information Notice No. 98/9, 23 February 1998.

¹² In 1996 the biggest private sector debtors were the banks, oil industry, telecoms, gas sector and power companies (*Latin American Weekly Report*, 11 March 1997).

recourse to financial tools such as the issue of public bonds and titles has increased dramatically; such bonds and titles represented 45.3% of Argentina's external debt in 1997.

Table I.4
External debt structure, 1991-97
(US\$ million and per cent)

	1991	1992	1993	1994	1995	1996	1997
External debt, total (EDT)	58,588	59,258	67,938	79,069	89,321	99,071	109,359
Debt by categories:							
A. Public non-financial sector, and Central Bank total	52,739	50,677	53,622	61,274	67,002	73,612	75,021
Public bonds and titles	1,100	3,020	31,596	36,881	37,968	46,180	49,530
Refinanced debt (Plan Financiero 1992)	31,341	29,375	0	0	0	0	0
International organizations ^a	7,962	7,104	10,501	11,322	15,088	15,710	16,121
Official creditors	9,042	9,207	9,765	10,917	11,609	10,040	7,810
Foreign commercial banks and other suppliers	3,294	1,971	1,760	2,154	2,327	1,672	1,560
B. Private non-financial sector total^b	775	2,061	5,435	6,996	8,692	9,803	13,840
Public bonds and titles	434	1,611	4,817	5,986	7,420	7,881	11,879
International organizations ^a	341	450	618	1,010	1,272	1,922	1,911
C. Financial sector (excluding Central Bank) total	5,074	6,520	8,881	10,799	13,627	15,656	20,498
Bonds and titles	109	780	1,991	2,812	2,516	3,975	5,006
Credit lines	3,037	4,104	4,312	5,225	7,249	6,948	7,374
International organizations ^a	299	301	295	327	331	501	459
Deposits	184	323	1,030	1,706	1,728	1,603	2,822
Other obligations	1,445	1,012	1,253	729	1,803	2,629	4,837
Memorandum:							
EDT/XGS (%)	397.5	403.4	436.3	428.8	374.9	366.4	383.8
External public debt / GDP (%) - IMF	..	..	23.4	24.7	24.4	25.9	26.3
RES/EDT (%)	12.6	19.4	22.5	20.2	17.8	19.9	...

.. Not available.

a These include the IMF, the World Bank and the Inter-American Development Bank.

b Data on direct financial and commercial debt is not available and thus not included.

Source: Data provided by the authorities of Argentina; Memorandum items: external public debt/GDP ratios from IMF Press Information Notice No. 98/9, 23 February 1998; and Reserves from MEOSP (1997), *Informe Económico No. 21 – Primer Trimestre de 1997*.

(3) DEVELOPMENTS IN MERCHANDISE TRADE

22. Following multilateral and MERCOSUR trade liberalization efforts as well as the fixing of the nominal exchange rate, Argentina experienced a growing merchandise trade deficit in the period 1992-94, but as a result of industrial productivity improvements, the implementation of the Real Plan in Brazil, and import compression following the Mexican crisis, there was a surplus in 1995 (Table I.3). Argentina, which has traditionally had a substantial merchandise trade surplus with other Latin American countries, has also developed a sizeable surplus with MERCOSUR partners. Export growth, led by energy products, manufactures (mainly transport equipment, stimulated by the automotive trade arrangement with Brazil, Chapter IV) and natural-resource-intensive goods, may be affected by reduced demand forecast for the Brazilian market in 1998; export competitiveness has been assisted by reforms which, *inter alia*, have helped to reduce energy and transport costs.

(i) Composition of trade

23. Since 1992 Argentina's merchandise trade structure has changed slightly. Exports are now less dominated by agriculture-related items, as a result of growth in mining products, petroleum, semi-manufactures and automotive products (Chart I.3). In the same period, imports have been concentrated in capital and intermediate goods; such investment-related imports are expected to increase the competitiveness of both manufactured exports and domestic output *vis-à-vis* competing imports.

(ii) Direction of trade

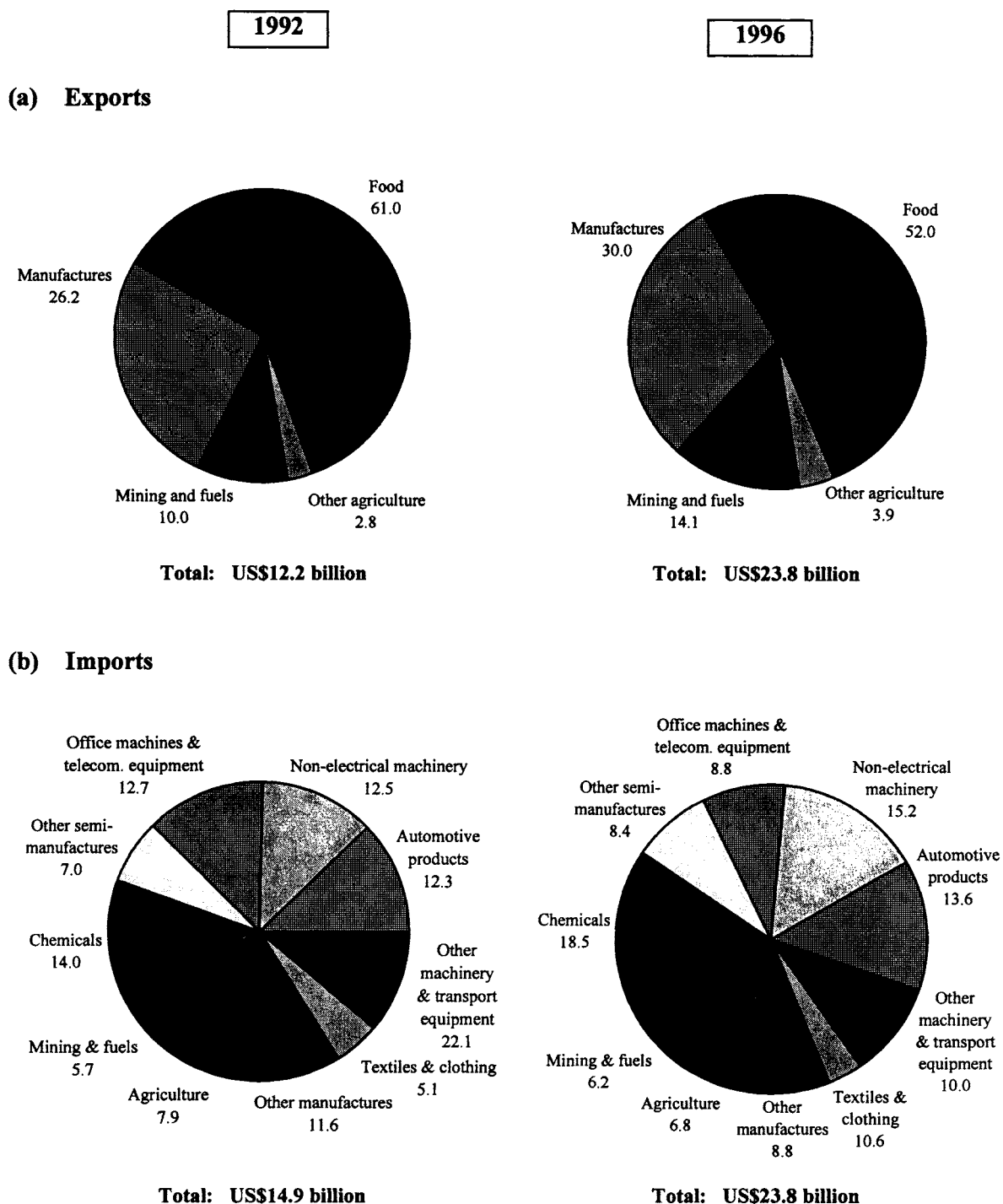
24. While the overall value of Argentina's regional trade has increased, this has been entirely export-led (Chart I.4). Between 1992 and 1996, the share of Latin America in Argentina's exports grew from 31% to 48% of the total: the share of MERCOSUR partners (mainly Brazil) increased from 19 to 33%. Imports from Latin America, however, showed no such increase, rather falling from about 34% to 31%, with MERCOSUR partners declining relatively less rapidly, from 25% in 1992 to 23% in 1995, rising to 24.4% in 1996.

25. MERCOSUR has become an increasingly important export market for Argentina's petroleum and motor vehicles, as well as a supplier of textiles, clothing, footwear and machinery (Chart I.5). Brazil, in particular, has become the largest single market for Argentine exports as a result of the implementation of the MERCOSUR customs union as well as its own unilateral trade liberalization, including the suppression of domestic subsidies for wheat production, and the demand boom created by the Real Plan; between 1992 and 1996 its share of Argentina's total exports more than doubled to almost 28% (Chart I.6). While the U.S. dollar value of trade with the EU and the United States has continued to grow, the rate of growth is less than that with MERCOSUR so that their share of exports has fallen slightly. The EU, Brazil and the United States remain the major sources of Argentine imports; the share of imports from east and south Asia has declined by 11.2%.

Chart I.3

Product composition of merchandise trade, 1992 and 1996

Per cent

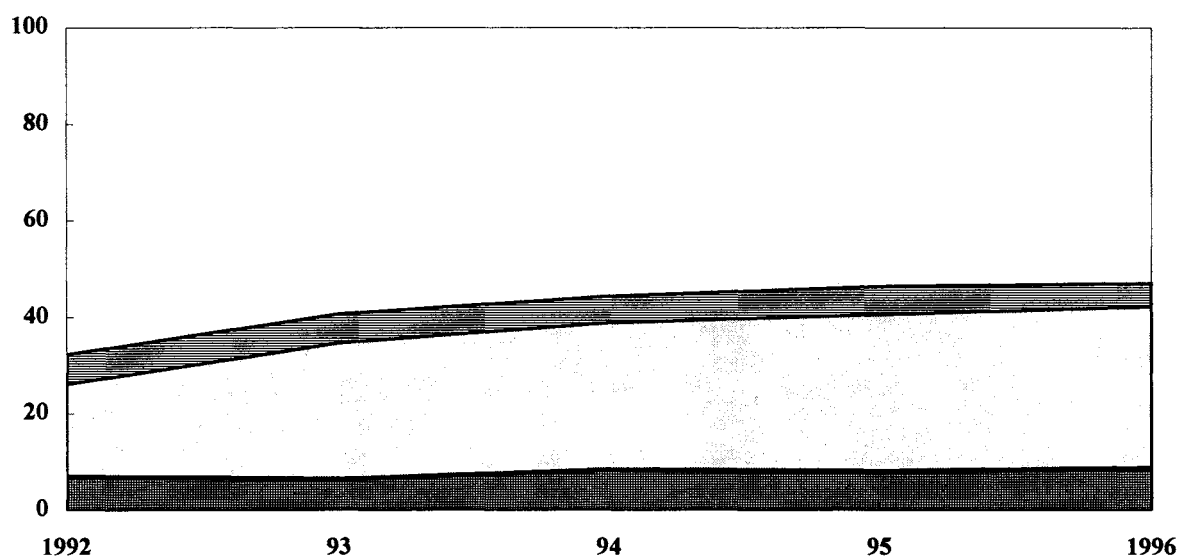


Source: UNSD, Comtrade database (SITC Rev.3).

Chart I.4
Argentina's trade with Latin America, 1992-96

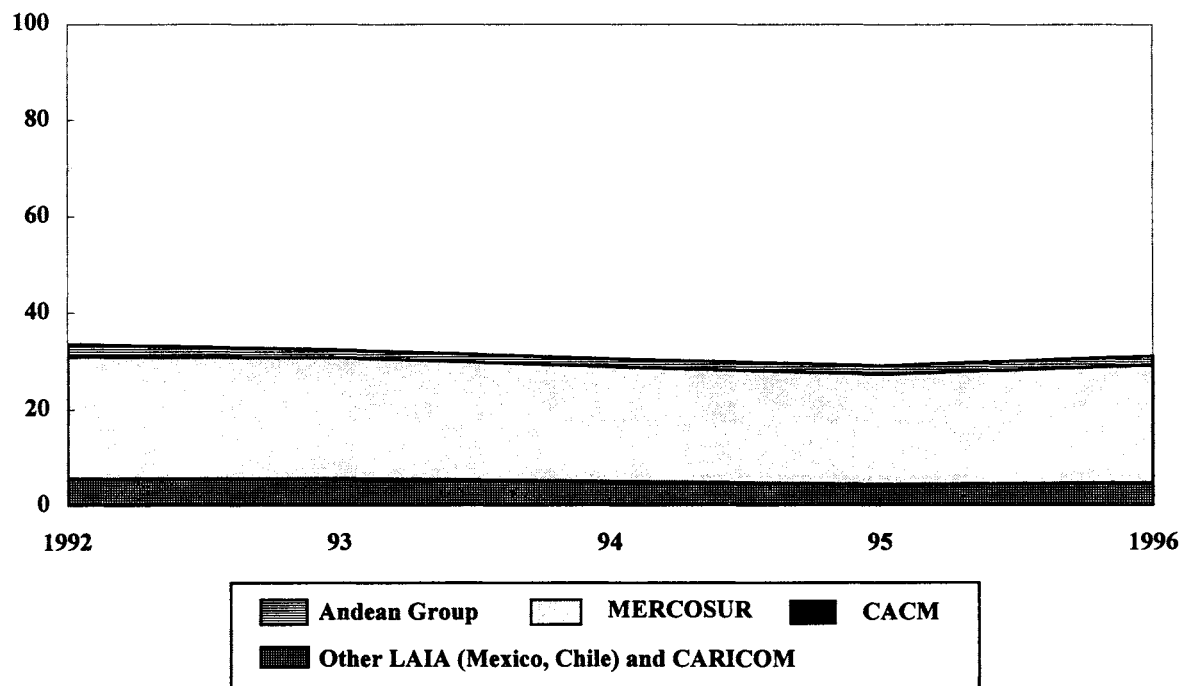
(a) Exports

Exports to group as share of total exports (per cent)



(b) Imports

Imports from group as share of total imports (per cent)



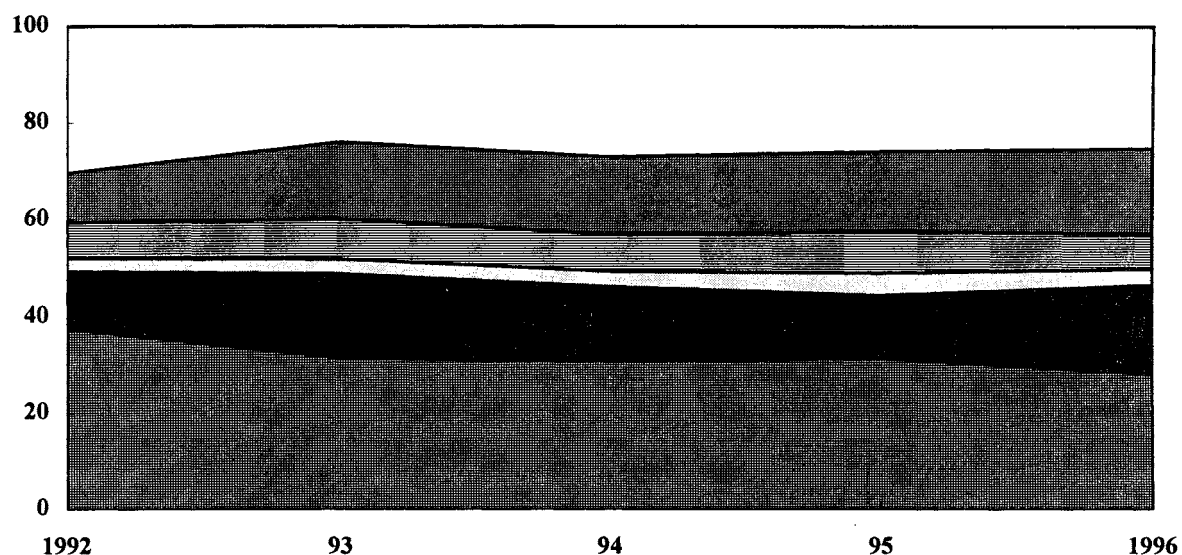
Source: UNSD, Comtrade database (SITC Rev.3).

Chart I.5

Argentina's trade with MERCOSUR by sector, 1992-96

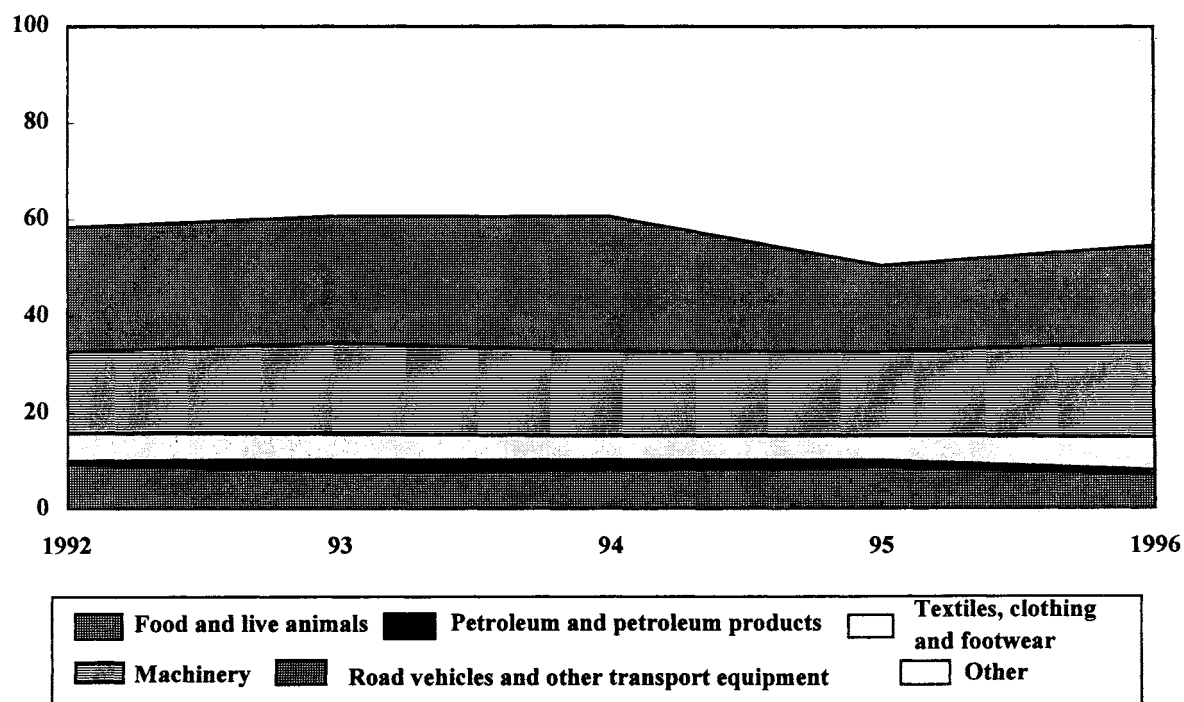
(a) Exports

Per cent of total exports to MERCOSUR



(b) Imports

Per cent of total imports from MERCOSUR

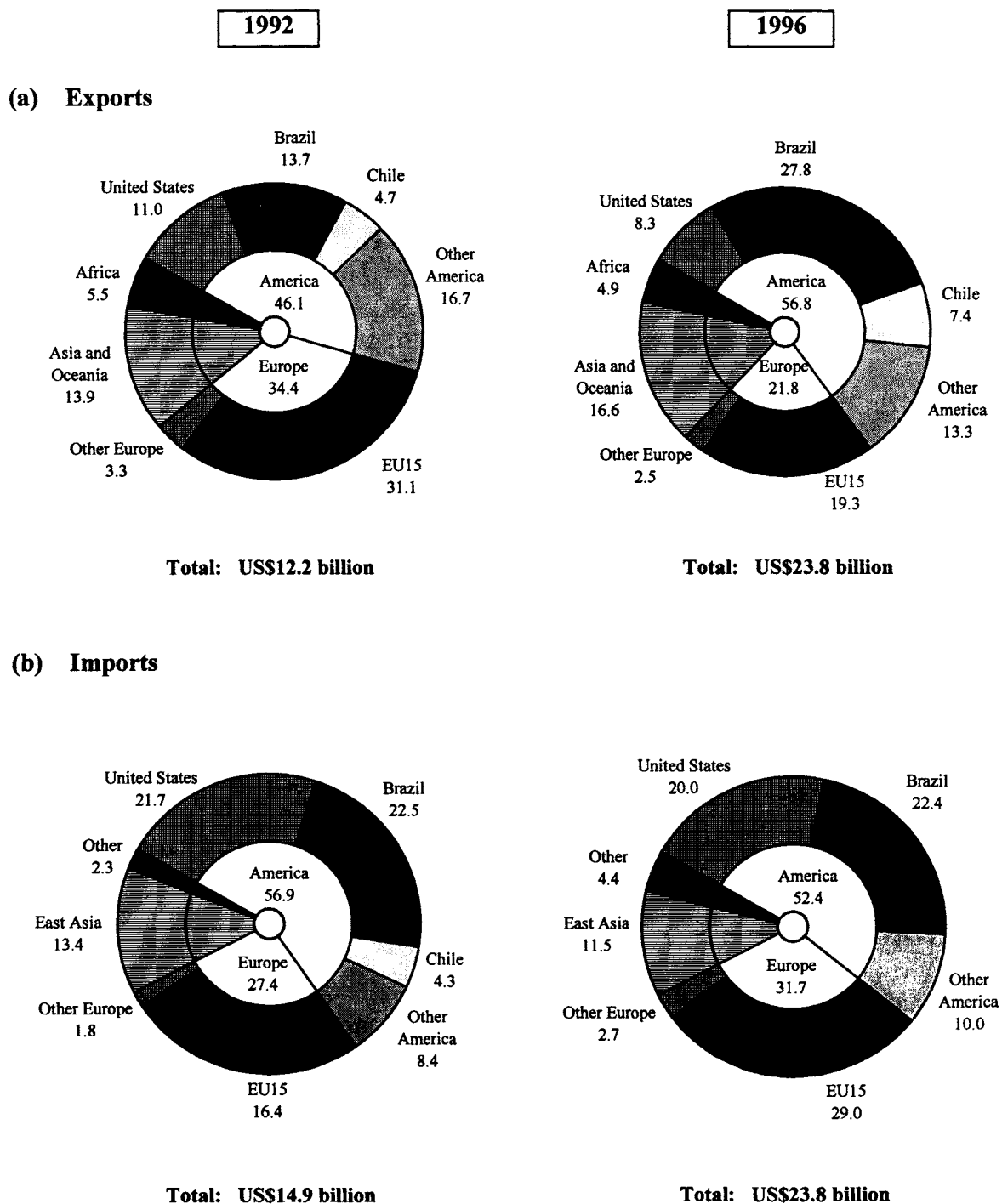


Source: UNSD, Comtrade database (SITC Rev.3).

Chart I.6

Merchandise trade by main origin and destination, 1992 and 1996

Per cent



Source: UNSD, Comtrade database.

(4) TRENDS AND PATTERNS IN FOREIGN INVESTMENT

26. Since the early 1990s, foreign direct investment (FDI), an essential element of Argentina's economic growth, has increased considerably, spurred by the pace of reform and the favourable conditions created under the Convertibility Plan and the new legal framework for investment (Chapter II). As a result, since 1991 Argentina has been the third largest destination of FDI flows in Latin America, after Brazil and Mexico, and the world's 14th largest recipient of net FDI inflows, after the EU and NAFTA countries, China, Singapore, Malaysia and Switzerland.¹³

27. Foreign investors have participated extensively in Argentina's privatization programme, becoming most involved in telecommunications, oil, electric power, gas, transportation, and water and sewerage; between 1992 and 1997 privatizations generated 22% of FDI inflows.¹⁴ Investment in public utilities, the first wave of privatizations, was favoured because, generally being monopolies, substantial returns on investment could be expected. However, the opening of the oil and gas sector to foreign investment has also generated large inflows in recent years.

28. Transnational corporations (TNCs) have accounted for the bulk of investment, about half of domestic sales (49% of manufacturing items sales) and over a third (38%) of exports.¹⁵ The insertion of TNCs in the market has been helped by the new investment framework and by the repositioning of Argentine-owned groups, which decided to concentrate on their core businesses.

29. Between 1992 and 1997 the FDI stock more than doubled to more than US\$36 billion (Chart I.7); investment has been concentrated in manufacturing (mainly food processing, motor vehicles, chemicals and petrochemicals), selected services, including public utilities, and extractive activities. Investment in electricity, gas, water supply, retail trade and telecommunications has grown rapidly in recent years. In recent years foreign direct investment has largely originated in the EU and the United States; however, Chile has also become a significant investor.

30. Forecasts indicate that between 1997 and 2000 the FDI stock is expected to increase by 64% to US\$52.9 billion, leading to further gains in productivity.¹⁶ All sectors, other than infrastructure-related projects, are forecast to benefit. The share of investors from Australia, Brazil, Canada, Japan, Republic of Korea, Spain and the United States is expected to rise; Spain is expected to become the second largest individual foreign investor in Argentina by the year 2000. To date, Spanish investment has been focused in manufacturing, infrastructure-related projects and the financial sector. Investment from Mexico is expected to rise once its agreement with MERCOSUR is concluded.

31. In recent years, Argentine firms have also increased their investment abroad, particularly within MERCOSUR. In 1995, the privatized oil company *Yacimientos Petrolíferos Fiscales* (YPF, Chapter IV) was the world's 8th largest transnational corporation in terms of assets held abroad.¹⁷

¹³ UN (1997).

¹⁴ MEOSP (1998b), p. 3; EIU (1997a), pp. 16 and 53.

¹⁵ Results of the *Mercado* survey contained in *Latin American Weekly Report*, 1 July 1997; *Latin American Weekly Report*, 25 November 1997.

¹⁶ Table 10.3 contained in MEOSP/CEP (1997), p. 91.

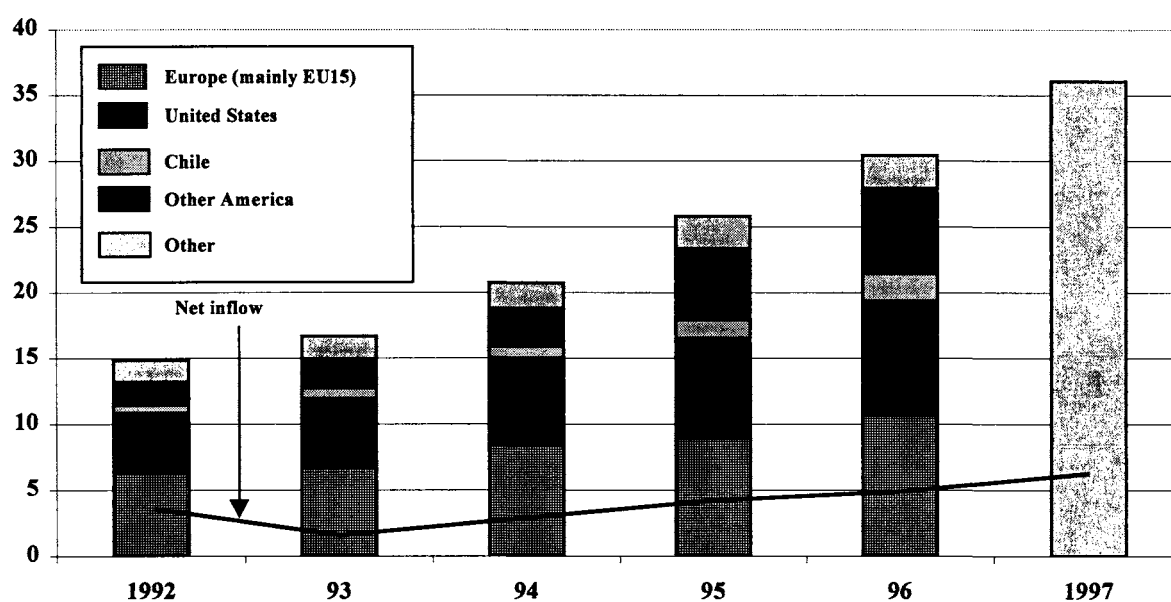
¹⁷ UN (1997).

Chart I.7

Net inflows and inward stock of foreign direct investment, 1992-97

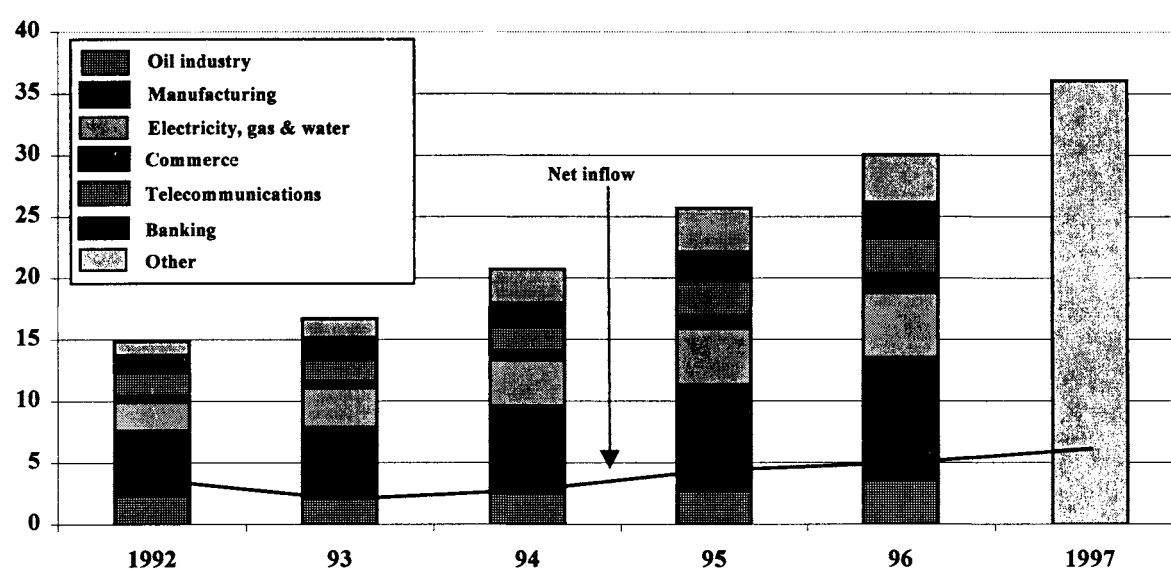
(a) By origin

US\$ billion



(b) By sector

US\$ billion



Note: Estimates for 1997; sectoral allocation not available and estimate for the 1996 net inflow.

Source: MEOSP (1998), *Inversión Extranjera Directa en Argentina, 1992-1997*.