

SPECIAL STRUCTURAL ADJUSTMENT PROGRAM AND  
STRENGTHENING OF BANKING SYSTEM SAFEGUARDS

(AR-0254)

EXECUTIVE SUMMARY

**BORROWER AND  
GUARANTOR:** The Argentine Republic

**EXECUTING AGENCY:** Ministry of Economic Affairs, for the structural adjustment loan; Central Bank of the Argentine Republic, for the loan to strengthen banking system safeguards

**AMOUNT AND SOURCE:** Structural adjustment loan (SAL)  
IDB: US\$2.0 billion (OC)  
World Bank: US\$2.5 billion  
Total: US\$4.5 billion

Loan to strengthen bank system safeguards  
IDB: US\$ 500 million (OC)  
World Bank: US\$ 500 million  
Total: US\$1.0 billion

**FINANCIAL  
TERMS AND  
CONDITIONS:** Amortization period:  
Grace period:  
Disbursement period:  
Interest rate:  
Special fee:  
Credit fee:  
Currency: U.S. dollars, Single  
Currency Facility

The financial terms and conditions will be those established by the Bank's Board of Executive Directors for what are being referred to as the 'emergency loans'.

**COFINANCING:** World Bank

Amortization period: 5 years  
Grace period: 3 years  
Disbursement period: 9 months for the SAL;  
60 months for the bank  
system safeguards loan  
Interest rate: LIBOR + 400 basis points  
Special fee: 1% front-end  
Credit fee: 0.75%, no waiver right

**RATIONALE AND  
OBJECTIVES:**

The global economic crisis of recent months is taking a toll on the emerging economies, creating conditions that are impeding country efforts to sustain the economic and social reforms launched in past years. The objective of the program proposed here is to protect the gains achieved in the course of these reform efforts and help continue and deepen them; this includes strengthening certain banking system safeguards instituted by the Central Bank. Immediate preventive measures are needed to avert more onerous adjustments in the public and private sector, which would dampen employment and cause problems in the fiscal accounts. The program also would strengthen the banking sector by better equipping the Central Bank to honor its agreements with commercial banks under the bond repurchase (REPO) facility.

**DESCRIPTION:**

The program proposes concerted preventive action by the multilateral lending agencies and the Argentine government, in the framework of the current Extended Fund Facility with the IMF. Specifically, with the World Bank the program would cofinance two mutually complementary and substantially similar loans comprising a single special program: (i) a quick-disbursing structural adjustment loan for the equivalent of US\$2 billion (IDB) and US\$2.5 billion (World Bank), and (ii) an operation to help bolster Central Bank safeguards for the country's banking system, for the equivalent of US\$500 million from the IDB and US\$500 million from the World Bank. The World Bank's Executive Board approved that agency's operation on November 10; the first disbursement of US\$1,025,500,000 was released on November 16, 1998.

1. Special structural adjustment program  
(US\$4.5 billion)
  - a. The program would help pursue and deepen reforms already under way. Disbursements would be tied to fulfillment of sets of conditions for each tranche, set out in a matrix agreed upon between the IDB, World Bank, and Argentine government.
  - b. The proposed policy matrix recognizes the progress and gains made by the government in its reform effort to date. It identifies key actions for consolidating these gains, and others that could be carried through in the first half of 1999, the final year of the current administration's term. The reforms that the program described here would support are summarized below.

Harmonization of federal-provincial fiscal relations. The fiscal decentralization effort pursued to date has made considerable progress, particularly as far as the decentralization of spending is concerned. However, much remains to be done to set more permanent instruments in place. To that end, the program proposes to: (i) move forward on streamlining and revamping the current tax revenue share-out arrangement, and (ii) support the adoption of provincial taxation mechanisms.

Financial sector. The program would support the following objectives: (i) further harmonize asset and financial-transaction taxes, to reduce distortions; (ii) strengthen safeguards in the Central Bank's bond-repurchase system with commercial banks; (iii) move forward with the sale of Banco Hipotecario and expedite the sale of portfolios of privatized provincial banks; (iv) improve the legal framework of the insurance sector; (v) strengthen regulation of securities rating agencies; and (vi) broaden access to credit, particularly by way of lease financing and securitized transactions.

Social safety net. The program will pursue the following aims in this area: (1) on the **poverty-reduction** front, (i) improve poverty measurement instruments, so that social protection programs can be better targeted; (ii) preserve levels of spending on priority programs targeted to education, health care, and employment; (iii) expand the current unemployment insurance system; (2) in the **education sector**, seek more equitable and efficient resource allocation in higher education by way of cost-recovery and scholarship programs and by tightening admission requirements; and (3) in the **health sector**, (i) improve the information system, administration, and coordination of resources of the Solidarity Fund; (ii) strengthen the Health System Superintendency; (iii) foster competition among organizations that provide health services to retired persons.

Public utilities regulatory capacity. The program's objective in this regard is to streamline and harmonize regulations governing tariff approval and reviews, fines, capital costs, service quality, appeals of regulatory agency decisions, and public information, among others,

the aim being to make the privatized utilities more efficient and improve their performance.

2. Program to strengthen banking system safeguards  
(US\$1 billion)

This operation would consist of a standby loan to the Argentine Nation, with the Central Bank as executing agency, to strengthen the Central Bank's system of banking safeguards – known as the REPO system – which was set in place as part of banking industry reforms. REPO is the acronym denoting the bond-repurchase arrangement between the Central Bank and a group of commercial banks. This facility was one of the safeguards put into place to assure that the banking system would have the necessary liquidity to withstand an eventual run on deposits. The proceeds of the loan could be disbursed when: (i) the government had satisfied conditions for release of the first tranche of the special structural adjustment program, and (ii) the Central Bank had activated its bond repurchase (REPO) facility with the commercial banks. The borrower would disburse a sum equivalent to these resources into a special Central Bank escrow account; they could be used to top up collateral margins in the event that the price of bonds delivered to the REPO Facility commercial banks fell by more than 5% and/or to repurchase these bonds.

**ENVIRONMENTAL/  
SOCIAL REVIEW:**

An environmental impact assessment is not required for this program.

**BENEFITS:**

The proposed operation will help entrench the far-reaching reforms being brought in by the government and mitigate financial contagion. The loan proceeds will help cushion the economic and social impact on the country, which would be most severe on segments of society that are the least equipped to protect themselves in an adverse climate.

**RISKS:**

The program appears to present no technical problems or risks of note. The content of the reforms has been examined with the Argentine government and other multilateral agencies; the measures proposed are workable and have the authorities' support. Nevertheless, there is a risk of problems in moving forward quickly on the reforms when the political backdrop will be an election year. Likewise, were the international financial crisis to persist beyond the first half of 1999, the financial situation would again be under pressure from high interest rates and volatility in the national financial system.

**THE BANK'S  
COUNTRY AND  
SECTOR STRATEGY:**

This being an emergency operation made necessary by an unforeseeable global financial crisis, it is not included in the country paper. However, the crisis has afforded the government a fresh opportunity to deepen reforms already under way and quicken their pace. The proposed program would support consolidation of public-sector reforms which are helping to achieve the macroeconomic conditions necessary to maintain competitiveness and protect coverage of social programs.

**POVERTY-TARGETING  
AND SOCIAL-SECTOR  
CLASSIFICATION:**

This program is defined as a special structural adjustment operation falling within the sector of modernization of the State. It cannot be classified as a poverty-targeted investment under the terms of paragraph 2.15 of the Eighth Replenishment document (AB-1704).

**EXCEPTIONS TO  
BANK POLICY:**

None.

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

Conditions precedent to the first disbursement. The conditions precedent to release of the first tranche of the structural adjustment loan refer mainly to reforms already carried through at this writing. They are referred to in the government's policy letter sent to the Bank, and in the first-tranche section of the policy matrix. These conditions have been reviewed by the IDB and World Bank and are considered to have been fulfilled. As a condition precedent to each tranche release, the borrower is to demonstrate to the Bank's satisfaction: (i) existence of the macroeconomic environment agreed upon with the IMF, and (ii) progress achieved on the key actions set out in the policy letter. The matrix also shows the conditions applying for the second and third tranches of this loan.

The loan for strengthening bank system safeguards will be eligible for disbursement when: (i) the first disbursement of the structural adjustment loan has been released, (ii) the special escrow account has been opened at the Central Bank, and (iii) the REPO facility with the commercial banks has been activated.

**PROCUREMENT:**

Not applicable.