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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL DEVELOPMENT ASSOCIATION

Tuesday, April 14, 1992

Washington, D.C.

The meeting of the Executive Directors was convened at 10:04 a.m. in the Board Room, 1818 H Street, N.W., Washington, D.C., Mr. Lewis T. Preston, Chairman, presiding.

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[redacted]

MR. PRESTON: [redacted]

Item 7 is a proposed loan under Special Procedure in the amount of $20 million to Argentina for a Second Tax Administration Project. Unless there are any questions, we shall record your approval and pass on to the next item.

Before doing so, I will ask Mr. Loh to make a brief statement on progress in Argentina's debt restructuring negotiations with its Bank Advisory Committee.

Mr. Loh.

MR. LOH: Thank you, Mr. Chairman, members of the Board.

I take great pleasure in reporting to you today the outcome of the negotiations between Argentina and its Commercial Bank Advisory Committee to reduce Argentina's external debt burden.

On April 8th, the Government of Argentina and its Commercial Bank Advisory Committee reached preliminary agreement on a deal to reduce Argentina's debt and debt service. This agreement represents another step in Argentina's adjustment process. Argentina has opened its economy, privatized major public firms and oil concessions, deregulated substantially, downsized the public sector, and modernized tax administration.

The Bank has supported these efforts through close policy dialogue and adjustment and technical assistance lending, and the IMF has recently signed an SDR 2.1 billion EFF agreement.

The Government's policy reforms have helped to reduce inflation from nearly 5,000 percent during 1989 to about 30 percent in the last 12 months, and to raise growth to some 5 percent in 1991.

As you know, Argentina is one of the most severely indebted countries, with external debt of about $65 billion, more than five times exports. External interest obligations are more than one-third of exports. Perhaps most importantly, given Argentina's history of fiscal imbalances and inflation, external interest obligations exceed 25 percent of tax revenues.

Argentina's largest individual creditors are the Inter-American Development Bank, the World Bank, and the IMF, in that order. Debt to the World Bank is about $2.8 billion currently. Argentina has fully serviced its debt to preferred creditors and its dollar-denominated bonds.

Debt to the Paris Club amounts to about $7 billion. Argentina and the Paris Club have agreed on four different reschedulings since 1985, most recently after the 1991 IMF standby.

Argentina's medium and long-term commercial bank debt is about $35 billion, representing about 53 percent of its external debt. Much of this debt was built up in the late 1970's and early 1980's when public sector borrowings financed fiscal imbalances and inconsistent exchange rate policies while private capital flowed outward.

At various times in the 1980's, Argentina incurred arrears on its commercial bank debt. Arrears now represent 22 percent of the total. Interest obligations to commercial banks, including interest on the arrears, were an estimated U.S. $2.5 billion in 1991, equivalent to more than 20 percent of exports.

Over the last two years, the Government has improved its relations with commercial banks by maintaining close contacts and steady partial debt service. In January 1991, payments were raised to U.S. $60 million per month, roughly 29 percent of the interest due. In addition, holders of Bank debt benefitted from a rise in the secondary market price of Argentina's debt from about 15 percent in 1990 to about 38 percent at the end of 1991, which in part reflects the policy-based improvements in Argentina's macroeconomic prospects.

As the stabilization and adjustment policies supported by the Bank and the IMF have taken hold, the Government has moved to reduce its external debt burden, first through private debt-equity swaps, then through equity-debt swaps linked to privatization, most notably the telephone company privatization that extinguished nearly $5 billion of debt, and finally through negotiations where full-fledged debt and debt service reduction operations that have culminated in the just concluded agreement in principle.

The agreement in principle between Argentina and its Commercial Bank Advisory Committee is similar to the Mexico and Venezuela debt and debt service reduction deals. The agreement is comprehensive. It covers all the estimated $32 billion of eligible foreign commercial bank debt, including nearly $8 billion of arrears. The arrears represent the main difference between the Argentina and the Mexico or Venezuela deals, since the latter two had no arrears on debt to commercial banks. Under the agreement, the owners of commercial bank debt will be able to exchange their holdings for one of the following two options.

First, a registered 35 percent discount bond of 30-year term and bearing LIBOR plus 13/16 percent. The bond has a single amortization payment at the end of 30 years. The amortization payment and 12 months of interest will be collateralized.

Second, a registered par bond, also of 30-year term. The interest will begin at 4 percent and rise gradually to a fixed 6 percent of the sixth year. The single amortization payment and the 12 months' interest will also be collateralized.

These two options are similar in terms of expected present value. Obviously, the attractiveness to individual creditors will depend on each creditor's expectation regarding future interest rates, each creditor's discount rate, and the tax and banking regulations facing each creditor.

The arrangements for the use of instruments in debt-equity swaps and for non-dollar creditors are now being negotiated.

Finally, a restructuring option also has been defined. This is likely to be taken up by only a few creditors.

As I noted, an important part of the deal is the settlement of about $8 billion in arrears, including interest on the unpaid interest, which will be calculated at the 30-day LIBOR rate until January 1992. The arrears will be settled at closing with the following: First, the payment of U.S. $400 million; second, exchange of U.S. $300 million of medium-term Argentina zero coupon notes valued at the market price and fully collateralized by U.S. Government obligations, and third, an exchange of Argentina 12-year bonds bearing LIBOR plus 13/16 for the remainders. These bonds will not be collateralized and carry three years' grace on principal and a back-loaded amortization schedule.

Roughly speaking, expected interest payments to commercial banks under the agreement are likely to be about $1.4 billion in 1993. The exact payments will, of course, depend upon the options chosen by the creditors and the LIBOR rate.

Turning to the question of funding, about $3 billion will be needed to collateralize the two new instruments plus a $700 million payment on arrears. The exact amount of collateral will depend upon the mix of the options selected by the holder of Argentinean debt. If all the creditors were to opt for par bonds, which are more expensive in terms of enhancements, then about $3.7 billion of collaterals plus the $700 million for arrears will be needed.

To help to meet these funding needs, the Argentina Government has requested assistance from the World Bank and other multilateral and bilateral lenders. The Bank is discussing the overall resource envelope with the IMF, the IDB and the Japanese and Argentinean Governments, taking into account the potential realizations from the upcoming privatizations by the Argentinean Government. Under the just concluded EFF, Argentina will be eligible for substantial support for debt reduction, including set-asides and freestanding interest support loans.

Consistent with the World Bank's policy guidelines, the Bank is examining the possibility of set-asides on the upcoming adjustment loans, retroactive set-asides on outstanding loans, and a freestanding loan supporting the ongoing adjustment process.

The IDB and the Japanese Government are currently being consulted on their support. The Argentinean Government, of course, supplies the funding for the restructuring of the arrears and the residual amount of collateral out of the resources obtained from privatizations. We expect to have a clearer sense of the amounts needed for collateral in the next few weeks.

The Government Advisory Committee is currently preparing the term sheet, including the various options, and reconciling their figures on the debt. The final term sheet is expected to be available by June, and the final closing is expected to occur toward the end of 1992. The department is preparing a written brief on the deal for your consideration in mid-May.

A detailed analysis of the agreement and the specific recommendations on enhancements will be presented to you once the commercial banks have exercised their options. In the meantime, the department staff will be happy to discuss the questions you may have.

In conclusion, I would like to re-emphasize that the Argentina debt deal is a critical element in the ongoing process of improving the fundamentals--that is, incentives, fiscal accounts, and confidence--that will lead to sustained development in Argentina. In particular, the deal will solidify Argentina's re-entry into international capital markets and thereby facilitate the continuation of private capital inflows. Although the deal implies an increase in Argentina's cash outflow because Argentina has been incurring arrears, Bank and Fund projections indicate that the payment is fiscally consistent with 4 to 5 percent growth and low inflation.

Without these additional payments, a deal would have been impossible, and arrears would have continued to accrue. This in turn would have dampened the growing confidence in the adjustment process and probably would lead to a reversal of the substantial private capital inflows that occurred in 1991 with a corresponding drop in growth.

Thus the debt deal is expected to enhance materially Argentina's development prospects. The Government of Argentina has requested the Bank to continue its longstanding support for its process through the provision of enhancements to support the deal, and the Bank is considering appropriate response to that request.

Thank you very much, Mr. Chairman.

MR. PRESTON: Thank you, Mr. Loh.

Are there any comments or questions?

Mr. Collins?

MR. COLLINS: Thank you, Mr. Chairman.

I would just like to commend Mr. Husain and Mr. Loh and the Argentinean authorities for their diligence in this exercise. I think it is another opportunity for an historic occasion. We began the day with a discussion of historic developments, and I think it is rather nice to conclude the day with this historic development of Argentina, one would hope, returning to the capital markets.

I would say that we certainly look forward to working with Bank staff on developing a clear understanding of what enhancements will be required, and also would be very interested in Mr. Loh's statement for circulation to the Board. It was a very helpful statement.

Thank you very much.

MR. PRESTON: Thank you, Mr. Collins.

Mr. Camarasa?

MR. CAMARASA: Mr. Chairman, thank you very much.

We would like to express the gratitude of the Government of Argentina to the World Bank. We think that it has been decisive in the conclusion of this agreement, and is further proof of the longstanding relationship and support that Argentina has received from the Bank.

Thank you, Mr. Chairman.

MR. PRESTON: Thank you, Mr. Camarasa.

Are there any other comments or questions?

[No response.]

MR. PRESTON: If not, the loan is approved on the terms proposed.

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