EBS/84/212

CONFIDENTIAL

October 12, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Israel - Exchange Arrangements and Exchange System

The attached paper on recent changes in the exchange arrangements and exchange system of Israel is circulated for the information of the Executive Directors.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

ISRAEL

Exchange Arrangements and Exchange System

Prepared by the European Department and
the Exchange and Trade Relations Department

(In consultation with the Legal Department)

Approved by L. A. Whittome and Subimal Mookerjee

October 11, 1984

In the attached communication dated October 4, 1984, the Israel authorities have informed the Fund of certain economic policy measures recently introduced, including a devaluation of the shekel and modifications to Israel's trade and payments system. These measures were aimed at arresting the decline in foreign exchange reserves and reducing inflationary pressures in the medium term. The steps, which were taken with a view to their speedy impact, are seen by the authorities as a bridging device until more basic measures--in particular, an agreement between the Government and representatives of employers' and employees' organizations on an overall price and incomes policy--can be put in place. Inflationary pressures are expected to ensue in the period immediately ahead because of these measures, but the authorities believe that the attendant reduction in public expenditures and restraint on private disposable incomes will bring benefits in the medium term.

As indicated in the attached communication, the measures can be summarized as follows:

1. On September 17, the shekel was devalued by 8 percent (approximately 9 percent on a local currency basis) in addition to the regular depreciations--which the authorities have reaffirmed that they would continue--to reflect inflationary differentials; at that date, the representative rate was IS 395.79 = US$1, as against IS 364.09 = US$1 on September 14.

2. Fiscal measures have been taken to absorb liquidity in an amount equivalent to about US$1 billion on a full fiscal year basis. On the expenditure side, subsidies have been cut on a range of commodities for which prices are controlled, resulting in an estimated saving on expenditures of US$215 million; prices of these commodities were accordingly increased on September 24 by between 18 percent and 55 percent. Various steps have been taken on the revenue side, including application of income taxes to certain child allowances and pensions, an increase in

the education levy, introduction of a monthly tuition fee for kindergarten and secondary education, as well as an increase in payments on services provided by local authorities, health institutions, and universities.

3. Effective October 3, a six-month ban was imposed on imports of some 50 commodities considered to be luxury items; these included passenger cars, large trucks, and sports boats; television sets, video recorders, and audio equipment; air conditioners; certain kitchen equipment; liquor and soft drinks; and certain expensive building materials. This ban is expected to affect imports amounting to US$700 million, on the basis of 1983 data.

4. On the import items now banned (see 3. above) and currently stored in bonded warehouses or en route to Israel, a compulsory one-year deposit of 25 percent--not indexed to domestic prices--is to be levied from October 3. This deposit, which is to be made on release of the import from customs, is in addition to the current 15 percent import deposit requirement.

5. Effective October 3, a compulsory deposit of 15 percent payable in domestic currency was required on that part of foreign package tours covering payment for hotels, land transport, and other related services; the required deposit is not indexed to domestic prices and is for a one-year period.

6. Effective October 3, the foreign currency allowance for Israeli residents traveling abroad was reduced for each journey from US$2,000 to US$1,000 for adults and to US$500 for children aged 12 years and below.

7. Effective January 1, 1985, the use of credit cards abroad by Israelis will be prohibited.

The measures described above in paragraphs 6 and 7 involve the intensification of exchange restrictions previously notified to the Executive Board and unapproved (EBS/84/162, 8/3/84). The recent policy steps, indicated above, are viewed by the authorities as bridging arrangements until more basic measures can be implemented and have their effect. The new coalition Government is in the process of formulating its economic strategy and further measures--particularly in the price and incomes field--are expected to be announced. The staff is of the opinion that implementation of a comprehensive set of fiscal, monetary, and incomes policies is critically important to help deal with Israel's severe economic problems. In these circumstances, no action by the Executive Board is proposed at this time.

October 4, 1984
To: Interfund, Washington, D.C.
Att: Dr. J. J. Polak

Dear Mr. Polak,

1. In an effort to improve Israel's balance of payments position and reduce inflationary pressures in the medium term, the Government has formulated a number of measures to reduce the public sector deficit and has taken steps to stem the adverse developments in the country's foreign exchange reserves. These administrative steps were taken because of their impact in the short term as a bridging device until the basic measures will exert their influence.

2. Within the framework of the budget the Government has adopted liquidity-absorbing measures in an amount of approximately US$1 billion equivalent (on the basis of a full fiscal year). Cuts in expenditures include a US$215 million reduction in subsidies for price-controlled commodities. Thus, prices of such commodities increased on September 24 between 18 and 55 percent.

In addition, measures have been adopted that will influence government revenue:

(a) Income tax rates will be applied to certain child allowances and old-age pensions.

(b) The education levy will be increased from 0.4 to 0.6 percent of taxable income.

(c) A monthly tuition fee will be introduced for kindergarten through secondary education in amounts from IS 4,000 to IS 6,000 per family, linked to the August price index.

Furthermore, payments for services provided by local authorities, health institutions, universities, etc., will increase substantially.

3. In connection with the deterioration in the level of foreign exchange reserves the Government has taken the following steps, effective October 3:

(a) A six-month ban on imports of some fifty commodities, among which passenger cars, large trucks and sport boats, TVs, video recorders and audio equipment, air conditioners, kitchen equipment, such as refrigerators, ovens, dishwashers, and washing machines, liquor and soft drinks, expensive building materials, such as marble and ceramics, certain toiletries, furniture, and fur clothing.

On such commodities that are presently stored in bonded warehouses, or are being shipped to Israel, a compulsory nonlinked deposit of 25 percent will be levied upon release from customs (in addition to the 15 percent already in effect).

The import ban is expected to affect US$700 million worth of annual (1983) imports.

(b) A compulsory deposit of 15 percent on that part of foreign package tours that covers payment for ground services.

(c) A reduction in the foreign currency allowance to Israeli residents traveling abroad from the present US$2,000 per person to US$1,000 for adults and US$500 for children aged 12 and below.

(d) A prohibition on the use of credit cards abroad by Israeli residents as of January 1, 1985.

Earlier, on September 17, the shekel was devalued by approximately 9 percent in an effort to neutralize public expectations-cum-foreign exchange acquisitions by the private sector.

4. Some of the measures described above will cause, in the short run, a substantial rise in the price level. However, it is expected that the reduction in public expenditures, including its impact on the private sector's disposable income, and the foreign exchange-related measures, together with the continued policy of nominal devaluations in line with inflation differentials, will set the stage for an agreement between the Government, the employers' organization, and the labor union on an overall incomes and price policy that would drastically reduce the level of inflation.

With kind regards,

Dr. Moshe Y. Mandelbaum
Governor
Bank of Israel