EBS/84/268

CONFIDENTIAL

December 27, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Bolivia - Exchange System

Attached for the information of the Executive Directors is a paper on certain changes that have been introduced to Bolivia's exchange system.

If Executive Directors have technical or factual questions relating to this paper, they should contact Mr. Sol-Pérez (ext. 8627).

Att: (1)

INTERNATIONAL MONETARY FUND

Bolivia--Exchange System

Prepared by the Western Hemisphere Department and the Exchange and Trade Relations Department

(In consultation with the Legal Department)

Approved by E. Wiesner and W. A. Beveridge

December 27, 1984

In the attached communication dated December 4, 1984 the Bolivian authorities have notified the Fund of certain changes that have been introduced to Bolivia's exchange system. This paper reviews these changes as well as other recent economic developments in Bolivia.

I. Background

In April 1984 the authorities announced a set of economic measures aimed at economic stabilization. These measures, which included adjustment of the official buying exchange rate from $b 500 to $b 2,000 per U.S. dollar, were described in EBS/84/107, 5/4/84. The announcement of the economic measures was followed by widespread labor unrest in the country, and the complementary measures planned in the areas of demand management, wage, interest rate, and pricing policies were not completed. Furthermore, Congress did not approve key proposals to create new taxes or modify existing tax laws. Inflation accelerated sharply thereafter, but most government controlled prices were kept unchanged while large retroactive wage increases were granted around midyear.

The exchange rate system remained unchanged until mid-August, when the system of two rates--$b 2,000 (buying) and $b 2,100 (selling) per U.S. dollar--was replaced by a complex system involving five exchange rates, ranging from $b 2,000 (buying) per U.S. dollar for "essential imports" to $b 5,250 (selling) per U.S. dollar for "complementary imports." However, the exchange measure was taken in isolation, and during the August-November period a number of important features of the new exchange system were not finalized, including the list of imports eligible for the essential exchange rate and the mechanism to determine the parity exchange rate (EBS/84/250, 9/20/84).

Domestic inflation, a measured by the Consumer Price Index, continued to accelerate markedly and registered monthly rates of increase of 15 percent in August, 37 percent in September, and 59 percent in October. The increase in domestic prices during the 12-month period ended in October 1984 was 1,591 percent, and the compounded rate of inflation of the month of October 1984 was equivalent to an annual inflation rate of 26,000 percent.

Following the April exchange rate adjustment, the real effective rate in the official market (base 1980 = 100) depreciated by almost 40 percent from March to May 1984. However, because a flexible exchange rate policy was not implemented thereafter, the real effective rate of the peso in the official market appreciated by more than 180 percent from May to October 1984.

Throughout the year, Bolivia maintained the following restrictive exchange practices subject to the Fund's approval jurisdiction under Article VIII: (a) external payments arrears, which as of June 30, 1984 amounted to US$561.2 million dollars; (b) restrictions on the availability of foreign exchange for imports and invisible payments; and (c) multiple currency practices arising from the spread of 5 percent between the buying and selling rate in the official market, from the existence of recognized parallel market operations, and from multiple rates in the official market.

II. Modification of the Exchange System

According to the attached communication from the Bolivian authorities, with effect from November 23, 1984, a single exchange rate for the Bolivian peso of $b 8,571 (buying) and $b 9,000 (selling to the general public) per U.S. dollar has replaced the system involving five exchange rates introduced on August 17, 1984. However, two new exchange rates have been established for airline tickets paid for in local currency and for conversion of mining sector foreign exchange receipts. The spread between the two rates in the major market is 5 percent, and includes a tax on the sale of foreign exchange (4.8 percent of the buying rate); a 1.5 per thousand commission for the Central Bank; and a $b 5.00 banking commission. Measured in relation to the previous selling rates, in terms of U.S. dollars, of $b 2,100 for "essential imports" and of $b 5,250 for "complementary imports," the new selling rate of $b 9,000 is equivalent to a depreciation of about 77 percent and 42 percent, respectively. In practice, however, most official foreign exchange payments took place at the "essential import rate" since August 17, 1984.

On November 20, 1984 Ministerial Resolution No. 0296 of the Ministry of Aviation established an adjustment factor of 2.2 over the official exchange rate (in terms of Bolivian pesos per U.S. dollar) to determine the price for all airplane tickets paid for in Bolivian pesos. The Central Bank of Bolivia instructed the Ministry of Aviation to withdraw its resolution and cancel the adjustment factor, but the Ministry of Aviation has so far failed to implement the instruction; however, it modified the adjustment factor to 1.7 to account for movements in the parallel exchange market. Thus, the Ministry of Aviation at present applies an exchange rate of $b 15,300 per U.S. dollar for airplane tickets paid in Bolivian pesos.

On December 5, 1984 as a result of an agreement between the Government and the Bolivian Confederation of Labor (COB), a special exchange rate of $b 17,500 per U.S. dollar was established to liquidate mining sector earnings.

III. Other Economic Measures

Together with the exchange rate adjustment, the Bolivian authorities announced certain measures in the areas of controlled prices, wages, and institutional arrangements.

On November 23, 1984 controlled prices for bread, flour, noodles, rice, meat, edible oil, coffee, milk, eggs, sugar, petroleum derivatives, and electricity rates were increased by amounts which ranged from 20 percent (rice) to 650 percent (kerosene). Most of these prices had been frozen since April 12, 1984 when the Bolivian authorities last announced a set of corrective measures. However, on December 5, 1984, the Government agreed to postpone for at least 30 days the price increases for basic foodstuffs and other consumer goods defined as essential.

Following negotiations between the Bolivian Confederation of Labor (COB) and the Government, the minimum wage was increased from $b 123,875 to $b 797,855, on November 23, 1984 (retroactive to November 1, 1984), and to $b 935,703 on December 5, 1984 (also retroactive on November 1, 1984; Supreme Decree No. 20637, 12/6/84). The new minimum wage represents an increase of 655 percent relative to the October 1984 minimum wage. Furthermore, all wages and salaries above the minimum level would also be increased by 655 percent.

On November 23, 1984 the following changes in institutional arrangements were announced by the Government: (a) extension of workers' co-management from the State Mining Company to all other public enterprises; (b) creation of a new National Council for Foreign Trade to devise a strategy on dealing with the external public debt and foreign trade and to supervise the restructuring of the debt; and (c) creation of a state insurance enterprise to handle all insurance operations of entities with majority government participation. On December 5, 1984 the Government agreed to participation of the Bolivian Confederation of Labor in the Committee for the Allocation of Foreign Exchange, with a right to veto.

IV. Staff Appraisal

In recent years Bolivia has experienced a worsening economic situation accompanied by increasingly severe internal and external imbalances. To a very large extent, these imbalances are attributable to the progressive expansion of the deficit of the nonfinancial public sector, which is financed almost entirely through domestic credit expansion. The staff is of the view that only the sustained implementation of a comprehensive set of measures--including strong fiscal action, a moderation in wage policy, and the pursuit of more realistic and flexible exchange rate, interest rate, and pricing policies--will redress the imbalances over time (SM/84/141, 6/20/84, and Cor. 1). In view of the highly expansionary wage policies agreed by the Government and the absence of any strong fiscal action, the deficit of the nonfinancial public sector is expected to widen considerably, thus fueling inflationary pressures during the coming months. The increase in government controlled prices is a justified and long overdue effort to catchup with domestic inflation, but supply rigidities and price distortions are likely to be intensified in view of the Government's commitment to freeze these prices for at least 30 days.

At the conclusion of the 1984 Article IV consultation in July 1984, Fund approval was not granted for Bolivia's exchange restrictions--including external payments arrears--and multiple currency practices subject to Article VIII, in view of the absence of policies that would permit Bolivia to phase out these exchange practices. The announced reduction in the number of multiple exchange rates is a step in the right direction since it simplifies the highly complex system introduced in mid-August, and adjusts the exchange rate to more realistic levels. However, in the presence of current fiscal, wage, interest rate, and other economic management policies, the new measure does not of itself constitute a solution of the country's very difficult economic situation, and notwithstanding the simplification of the exchange system, restrictions remain in effect and external payments arrears have accumulated. Furthermore, the emergence of two de facto exchange rates, resulting from the actions of the Ministry of Aviation and from the Government agreement with the Bolivian Confederation of Labor to liquidate mining sector export earnings, introduces multiple currency practices subject to Fund approval, in addition to the multiple currency practices arising from the 4.7 percent spread between buying and selling rates for foreign exchange and the recognized exchange rate in the parallel market. The appreciation of 180 percent in the real effective rate in the official market from May to October 1984 (1980=100) indicates that, following the most recent exchange rate adjustment, continued maintenance of a flexible exchange rate policy will be necessary to ensure that Bolivia's competitiveness is raised to a degree consonant with a sustainable balance of payments position. In order to help improve the short- and medium-term prospects of the Bolivian economy, the staff is of the view that the Bolivian authorities should move to a unitary and flexible exchange rate system in the context of a comprehensive economic stabilization program that would permit the elimination of arrears and other restrictions. No action by the Executive Board is proposed at this time.

ATTACHMENT I

LA PAZ, DECEMBER 4, 1984

TO TREASURER'S DEPARTMENT IMF
WASHINGTON, D.C.

PURSUANT TO SUPREME DECREE NO. 20608 OF NOVEMBER 23, 1984, A SINGLE EXCHANGE RATE IS RE-ESTABLISHED IN BOLIVIA. IT IS SET IN RELATION TO THE U.S. DOLLAR AS FOLLOWS:

BUYING PRICE	8,571
1.5 PER THOUSAND COMMISSION FOR CBB	13
4.8 PERCENT TAX FOR TREASURY OF THE NATION	411
SELLING PRICE TO BANKS AND PUBLIC SECTOR	8,995
BANKS' COMMISSION	5
FINAL SELLING PRICE	9,000

THE NEW EXCHANGE RATE APPLIES TO ALL FOREIGN CURRENCY TRANSACTIONS BEGINNING NOVEMBER 23, 1984. THEREFORE PLEASE APPLY THE BUYING RATE, $B 8,571 PER US$1, TO ALL OUR OPERATIONS WITH YOU.

ON NOVEMBER 20, 1984 THE MINISTRY OF AVIATION ISSUED MINISTERIAL RESOLUTION NO. 0296 INTRODUCING AN ADJUSTMENT FACTOR OF 2.2 OVER THE OFFICIAL EXCHANGE RATE FOR ALL AIRPLANE TICKETS PAID FOR IN BOLIVIAN PESOS. SINCE THIS RESOLUTION IN EFFECT ESTABLISHES AN ADDITIONAL OFFICIAL EXCHANGE RATE, WHICH IS NOT AUTHORIZED BY THE CENTRAL BANK, THE MINISTRY OF AVIATION HAS BEEN INSTRUCTED TO WITHDRAW ITS RESOLUTION AND CANCEL THE ADJUSTMENT FACTOR.

REGARDS

JAIME ROSSELL M.
GENERAL MANAGER
NAVIANA