EBD/88/85

March 16, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Dominican Republic - Exchange Arrangements

Attached for the information of the Executive Directors is a paper on a change in the exchange arrangements of the Dominican Republic.

Mr. Weniger (ext. 8526) is available to answer technical or factual questions relating to this paper.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

DOMINICAN REPUBLIC

Exchange Arrangements

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

(In consultation with the Legal Department)

Approved by S.T. Beza and Eduard Brau

March 16, 1988

In the attached communication, dated February 17, 1988, the Dominican Republic authorities have notified the Fund of the introduction of an arrangement under which the currency would be appreciated gradually from RD$5.55 per U.S. dollar to RD$4.80 per U.S. dollar and then be allowed to fluctuate within a band of between RD$4.80 and RD$5.20 per US$1. The staff also has been notified of new reference exchange rates for the purpose of calculating ad valorem import tariffs.

On November 12, 1987, the Dominican Republic authorities had reestablished a unified, market-determined exchange rate system for all foreign exchange transactions (EBD/87/332, 12/22/87). Under the new arrangement which went into effect on February 11, 1988, the exchange houses and the commercial banks must deal in foreign exchange at the exchange rate fixed by the Central Bank instead of a market-determined rate. The dollar holdings of the exchange houses at February 11, 1988 had to be sold to the commercial banks at the exchange rate of RD$5.55 per US$1. On February 12, 1988 the buying and selling rates for the U.S. dollar were set at RD$5.40 and RD$5.45 per US$1, respectively. Since then, these rates have been reduced by 5 centavos each Friday, with the corresponding new rates coming into effect on the following Monday. The weekly adjustments will continue until the buying and selling rates reach RD$4.80 and RD$4.85 per US$1, respectively. The authorities have explained that the new arrangement was aimed at reversing the recent sharp exchange rate depreciation which they attributed to speculative forces.

The reference exchange rate for purposes of tariff calculation, which was previously set at RD$3.36 per US$1, has been changed to RD$5 per US$1 for imports of nonessential goods and to RD$8 and RD$10 per US$1 for motor vehicles of different engine capacities. Imports of essential goods will continue to be valued at the previous reference exchange rate of RD$3.36 per US$1. The authorities expect that the upward adjustment of the reference exchange rates for imports will generate significant additional fiscal revenues.

At the conclusion of the 1987 Article IV consultation with the Dominican Republic on August 14, 1987 Executive Directors urged the authorities to return soon to a unified free exchange system so as to provide adequate incentives to the export sector. The re-unification of the exchange markets on November 13, 1987 was in line with this recommendation and re-established the system that prevailed from early 1985 to mid-June 1987. The recent return to a pegging arrangement and the appreciation of the exchange rate could result in a re-emergence of a parallel exchange market and could lead to a reduction in external competitiveness, given the present rate of inflation. In these circumstances, the staff would encourage the authorities to return to a more market-determined exchange rate system and to pursue exchange rate stability through fiscal and monetary policies.

SANTO DOMINGO, DOM. REP.
FEBRUARY 17, 1988
02-713-88
MR. ALEXANDRE KAFKA
EXECUTIVE DIRECTOR
INTERNATIONAL MONETARY FUND
WASHINGTON, D.C.
USA

Please find below details of the latest tax and exchange rate measures adopted by the Dominican authorities.

A. New Ad Valorem

The State Secretariat of Finance has introduced a selective system for payment of the ad valorem tax, which maintains at 3.36 pesos to the dollar, the exchange rate applicable to stable foodstuffs, medicinal products, agro-industrial goods, agro-chemical products and industrial raw materials. A rate of 5 pesos to the dollar will apply to nonessential goods such as electrical household appliances, crockery, cutlery, fabrics, carpets, vehicle accessories, vinyl-coated paper, kettles, furniture and other household goods of foreign manufacture, office equipment, cameras, air conditioners, all types of lamps, electrical equipment, motorcycles, bicycles, tablecloths and footwear. For vehicles, the system establishes a three-level scale of payments: 5 pesos to the dollar for those with a f.o.b. value of 6,000 dollars or an engine capacity of 2,300 cubic centimeters, 8 pesos to the dollar for those with a f.o.b. value of more than 6,000 dollars and an engine capacity of between 2,300 and 3,300 cubic centimeters, and 10 pesos for each dollar of the f.o.b. value of those with an engine capacity of more than 3,300 cubic centimeters.

The aim of the measure is to reduce the country's imports and dampen the demand for dollars. On the basis of its preliminary calculations, the Secretariat of Finance estimates that, excluding the revenue accruing from the two higher rates (8 and 10 pesos to the dollar) applicable to vehicles, the new system will bring in 180 million pesos.

B. Exchange Rate Agreement

Because of the highly speculative situation on the free foreign exchange market in recent weeks, which led to massive withdrawals on deposits and threatened to provoke a crisis in the financial system, the monetary authorities and the exchange banks agreed to adopt measures aimed at stabilizing and reducing the exchange rate. Since technical estimates put the effective exchange rate at about 5.19 pesos to the dollar, the policy would be to have the exchange rate move within a band of between 4.80 and 5.20 pesos to the dollar.

The provisional agreement, which will last 90 days, is that as of February 11 all the exchange banks will sell off their dollar holdings through the commercial banks at 5.55 pesos to the dollar. Every Friday, commencing February 12, the exchange rate, which on that day was fixed at 5.40 pesos and 5.45 pesos (buying and selling rates, respectively), will be reduced by 5 points per week, with the new rate coming into force on the following Monday. Successive reductions will be made until the buying and selling rates reach 4.80 pesos and 4.85 pesos, respectively, on April 15, 1988. Any dollars which the exchange banks have not been able to sell on the day on which the new rate comes into force will be acquired by the commercial banks every Friday until 12 noon at the rate obtaining in the week in question. The other mechanisms involved in the operation of the free foreign exchange market will be left unchanged and the foreign exchange acquired by the Bank will be sold to importers via the commercial banks.

Regards.

DR. ROBERTO B. SALADIN SELIN
GOVERNOR OF THE CENTRAL BANK