EBS/85/68

CONFIDENTIAL

March 22, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Bolivia - Exchange System and Real Effective Exchange Rate - Information Notice

The attached paper on recent changes in the exchange system of Bolivia and an information notice on the real effective exchange rate of the Bolivian peso is circulated for the information of Executive Directors.

If Executive Directors have technical or factual questions relating to this paper, they should contact Mr. Flickenschild (ext. 8621).

Att: (1)

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INTERNATIONAL MONETARY FUND

Bolivia - Exchange System and Real Effective Exchange Rate--Information Notice

Prepared by the Western Hemisphere and Exchange and Trade Relations Departments

(In Consultation with the Legal Department)

Approved by E. Wiesner and Manuel Guitian

March 19, 1985

In the attached communication dated February 22, 1985 the Bolivian authorities have notified the Fund of certain changes in Bolivia's exchange system. This paper reviews these changes as well as certain other measures announced by the authorities at about the same time.

I. Background

In recent years economic activity in Bolivia has been disrupted by political turmoil, frequent and protracted strikes, and sharply rising inflation. The principal cause of the rapid inflation has been the widening public sector deficit, financed almost entirely by domestic credit expansion.

Efforts by the authorities to implement stabilization measures have failed principally because of the inability to correct the massive fiscal imbalance. Since the issuance of the last Article IV consultation report (SM/84/141, 6/20/84), Executive Directors have been informed about policy actions and other developments in connection with notifications about changes in Bolivia's exchange system.1/

II. Real Effective Exchange Rate--Information Notice

The recent evolution of Bolivia's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of January 1985, the Bolivian peso had appreciated in real effective terms by more than 10 percent since the last occasion on which developments in Bolivia's exchange rate were brought to the attention of the Executive Board--the notification of a change in Bolivia's exchange rate system in December 1984.2/ The appreciation is estimated to have amounted to 32.3 percent.

1/ EBD/84/191, 7/11/84; EBD/84/250, 9/21/84; and EBS/84/268, 12/27/84.
2/ EBS/84/268 (12/27/84).

III. Modification of the Exchange System

In accordance with Supreme Decree No. 20706 of February 8, 1985, the Bolivian peso was devalued from $b 8,571 to $b 45,000 per US$1 for foreign exchange purchases by the Central Bank and commercial banks in the official exchange market with effect from Monday, February 11, 1985. At the same time, the Central Bank began to apply new selling rates of $b 49,550 to commercial banks and $b 50,000 to the general public, compared with $b 8,995 and $b 9,000 per US$1 previously. On a mid-point basis, this action represents an 81.5 percent devaluation of the Bolivian peso for transactions with the general public. The spread of 11.1 percent between the new buying and selling rate (in terms of the buying rate) includes an exchange tax of 4.8 percent as well as prescribed commissions of $b 890 for the Treasury, $b 1,500 for the Central Bank, and $b 450 for the commercial banks. Supreme Decree No. 20706 also empowered the Central Bank Board to change the exchange rate periodically in accordance with government instructions so as to maintain its value in real terms. The parallel market rate at the end of February 1985 was about $b 110,000 per US$1.

On February 8, 1985 the authorities announced that exporters of goods and services would henceforth be able to use part of their export proceeds to cover their own foreign exchange needs (Supreme Decree No. 20707); private exporters of traditional non-mining and nontraditional products are to be allowed to retain 30 percent and 40 percent, respectively, of their net export proceeds. State enterprises continue to be required to surrender 100 percent of net export proceeds but are to be entitled to receive exchange certificates denominated in U.S. dollars for 30 percent of traditional exports and 40 percent of nontraditional exports. These certificates are to be used by the enterprises for the importation of raw materials and other imports, with unused certificates to be converted at the official exchange rate. Procedures to govern these new regulations have not been established yet. A special regime for hydrocarbon and mining exports is to be developed by the Central Bank in cooperation with the two ministries concerned. Because of their new retention privileges, private sector exporters no longer are to have access to official foreign exchange.

IV. Other Economic Measures

Together with the exchange rate actions described above, the authorities increased controlled prices and wages, took measures to protect the real value of tax liabilities, and acted to strengthen budgetary control. In addition, at the end of February 1985, they established a minimum interest rate to be paid on time and savings deposits and announced that lending rates would henceforth be determined by market forces. The authorities have also informed the staff that they are considering indexing domestic financial assets either to domestic prices or to the exchange rate, and that they intend to resubmit to Congress the tax proposals initially formulated in April 1984 (EBS/84/107, 5/4/84).

With effect from February 10, 1985, the Ministry of Finance set new price ceilings for controlled food items.1/ The increases in controlled prices generally reflected the length of time elapsed since the item in question was last adjusted. The National Electricity Commission (DINE) increased electricity rates by an average of about 9,700 percent (Supreme Decree No. 20710). The prices of petroleum derivatives were raised from 350 percent (liquified petroleum gas for industrial use) to 1,150 percent (aviation oil). The price of gasoline was raised by 505 percent to the equivalent of 25 1/2 U.S. cents per liter in terms of the new official buying rate. At the same time, the Ministry of Energy and Hydrocarbons was authorized to adjust the peso price of petroleum derivatives in line with future adjustments of the official exchange rate.

The authorities have indicated that the relevant ministries and local authorities had been authorized to adjust the tariffs for telecommunications, mail, railroad, and urban transportation services (Supreme Decrees No. 20716 and 20712). However, by the end of February 1985, only transportation tariffs had been adjusted.

Beginning February 1985, a nontaxable monthly bonus of $b 3.1 million (equivalent to 70 percent of the average central government wage) was mandated for all public and private sector workers (Supreme Decree No. 20713). Retirees, veterans, widows, and orphans also were acccorded a proportion of the bonus in accordance with existing legislaion. At the same time, a 60-day freeze was imposed on wages. Since then, however, the authorities have granted public and private sector workers a monthly transportation bonus of $b 1.3 million.

In the fiscal area, the authorities adopted two measures to protect the real value of tax liabilities. Beginning February 1985, businesses will be required to make income tax prepayments equivalent to 9 percent of their monthly sales (Supreme Decree No. 20708). The final income tax liability and its settlement will be determined after the close of the business year. In addition, all overdue tax liabilities are to be indexed to the consumer price index, and penalty interest and fines will be assessed on the adjusted value of such liabilities (Supreme Decree No. 20709).

The authorities have taken some measures in the monetary area. On February 26, 1985 (Central Bank resolutions 23-85 and 24-85) they established a minimum interest rate for time and savings deposits and set this rate at 20 percent a month; on a monthly compound basis, this minimum rate is equivalent to an annual rate of 792 percent. According to the new regulations, financial institutions can pay higher rates on deposits and can also determine their lending rates. Previously, interest rates on time and savings deposits were fixed at 140 percent and 110 percent a year, respectively, and lending rates were fixed at

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1/ Sugar, pasteurized milk, coffee, rice, flour, bread, noodles, beef, chicken, eggs, and cooking oil.

150 percent a year. Given recent inflation--an average of 60 percent a month during November 1984-January 1985--the new minimum deposit rates are still highly negative.

V. Staff Appraisal

The February 8, 1985 devaluation of the peso has provided a temporary improvement in the competitiveness of Bolivian exports. However, rapid inflation and the large and continuing depreciation of the peso in the parallel exchange market indicate that the peso remains overvalued in the official market, and underscore the need for a more flexible exchange rate policy. The exchange retention privileges provide export incentives that tend to adapt flexibly to the movement of the Bolivian peso in the parallel market. The staff is of the view, however, that a more market-related determination of the official rate would be preferable to reliance on such incentives. The retention rates create two new mixing rates that represent additional multiple currency practices at currently prevailing spreads of the exchange rates between the official and parallel markets. In addition, the more than doubling of the percentage spread between the buying and selling rate in the official market indicates an increase in the complexity of the existing multiple currency practice.

The exchange rate action was accompanied by a number of fiscal, pricing, and interest rate measures and proposals. However, recent experience with similar measures and proposals suggests a cautious attitude with regard to the effects to be derived from the latest measures. The experience so far has been that announced measures have been implemented with lags and less fully than planned. What is clear is that the correction of Bolivia's major fiscal imbalance will require further actions without delay. These actions would need to include new tax measures, improved tax administration, strict limits on spending, and control over the operations of the public enterprises.

In addition to the multiple currency practices already noted, Bolivia maintains exchange restrictions--including external payments arrears--and other multiple currency practices resulting from the maintenance of the officially recognized parallel market. The existence of arrangements for two de facto exchange rates for the purchases of tickets for travel abroad and for conversion of mining sector earning may also give rise to multiple currency practices. As present policies are not adequate to permit a phasing out of these exchange practices, no action by the Executive Board is proposed at this time.

Attachments

INTERNATIONAL MONETARY FUND,
WASHINGTON, D.C.

FEBRUARY 22, 1985

EXCHANGE RATE.

AS FROM 2/8/85 THE NEW EXCHANGE PARITY OF THE BOLIVIAN PESO IN RELATION TO THE U.S. DOLLAR AND THE RELEVANT TAXES AND COMMISSIONS ARE:

CENTRAL BANK BUYING PRICE FOR US$1.00	$b 45,000.00
CENTRAL BANK OF BOLIVIA COMMISSION	$b 1,500.00
NATIONAL TREASURY TAX OF 4.8 PERCENT AND EXCHANGE SUPERVISION DIRECTORATE	$b 2,160.00
NATIONAL TREASURY COMMISSION	$b 890.00
SELLING PRICE TO THE BANKING SYSTEM AND PUBLIC SECTOR	$b 49,550.00
ONE PERCENT BANKING SYSTEM COMMISSION	$b 450.00
FINAL SELLING PRICE FOR US$1.00	$b 50,000.00

ACCORDING TO SUPREME DECREE 20707 OF 2/8/85 30 PERCENT AND 40 PERCENT OF THE NET VALUE OF TRADITIONAL AND NONTRADITIONAL EXPORTS, RESPECTIVELY, MAY BE USED FOR THE IMPORTATION OF RAW MATERIALS AND INPUTS FOR PRODUCTION. THE PUBLIC EXPORTING SECTOR WILL RECEIVE THE RELEVANT PERCENTAGE IN THE FORM OF FOREIGN CURRENCY CERTIFICATES WHILE THE PRIVATE SECTOR MAY USE IT FREELY.

REGARDS

JAIME DELGADILLO, MANAGER, ECONOMIC STATISTICS

NAVIANA - ECONOMIC RESEARCH DEPARTMENT.

Table. Bolivia: Real Effective Exchange Rate and Related Series

(Indexes: 1980 = 100)

	Real Effective Exchange Rate 1/ 2/	Nominal Effective Exchange Rate 1/	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. dollars 1/	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1979						
I	90.4	110.8	81.6	122.5	61.8	62.5
II	93.1	114.1	81.5	122.5	64.8	63.7
III	92.9	114.3	81.2	122.5	68.2	68.0
IV	94.7	109.7	86.9	114.6	76.7	77.5
1980						
I	95.7	98.4	97.3	100.0	90.4	91.4
II	100.5	99.8	100.8	100.0	98.7	96.9
III	102.2	99.5	102.7	100.0	104.6	104.4
IV	101.6	102.4	99.2	100.0	105.9	107.3
1981						
I	119.9	107.4	111.6	100.0	124.7	125.6
II	131.5	118.5	110.9	100.0	130.4	128.2
III	140.6	127.4	110.3	100.0	136.6	136.1
IV	135.4	128.3	105.5	100.0	136.2	138.8
1982						
I	119.3	101.7	119.2	74.1	160.8	161.2
II	124.9	82.5	151.3	56.8	212.6	208.8
III	192.2	89.7	213.9	56.8	317.7	316.9
IV	138.6	47.2	308.6	28.2	481.1	494.6
1983						
I	82.9	22.1	374.3	12.5	615.1	612.4
II	109.2	23.6	461.4	12.5	804.4	789.9
III	155.1	25.3	611.0	12.5	1,138.2	1,134.1
IV	160.2	18.4	913.9	8.6	1,835.4	1,901.1
1984						
I	169.1	11.4	1,488.7	4.9	3,207.2	3,188.0
II	142.3	4.2	3,655.0	1.7	8,503.7	8,324.7
III	167.1	3.3	5,021.1	1.2	12,533.6	12,488.4
IV	303.8	2.6	13,228.4	0.9	35,804.2	37,295.0
Monthly						
1985						
January 3/	180.7	0.8	23,039.3	0.2	65,359.2 4/	...
Percentage change Dec. 1984-Jan. 1985	32.3	4.1	27.1	--	30.5	...

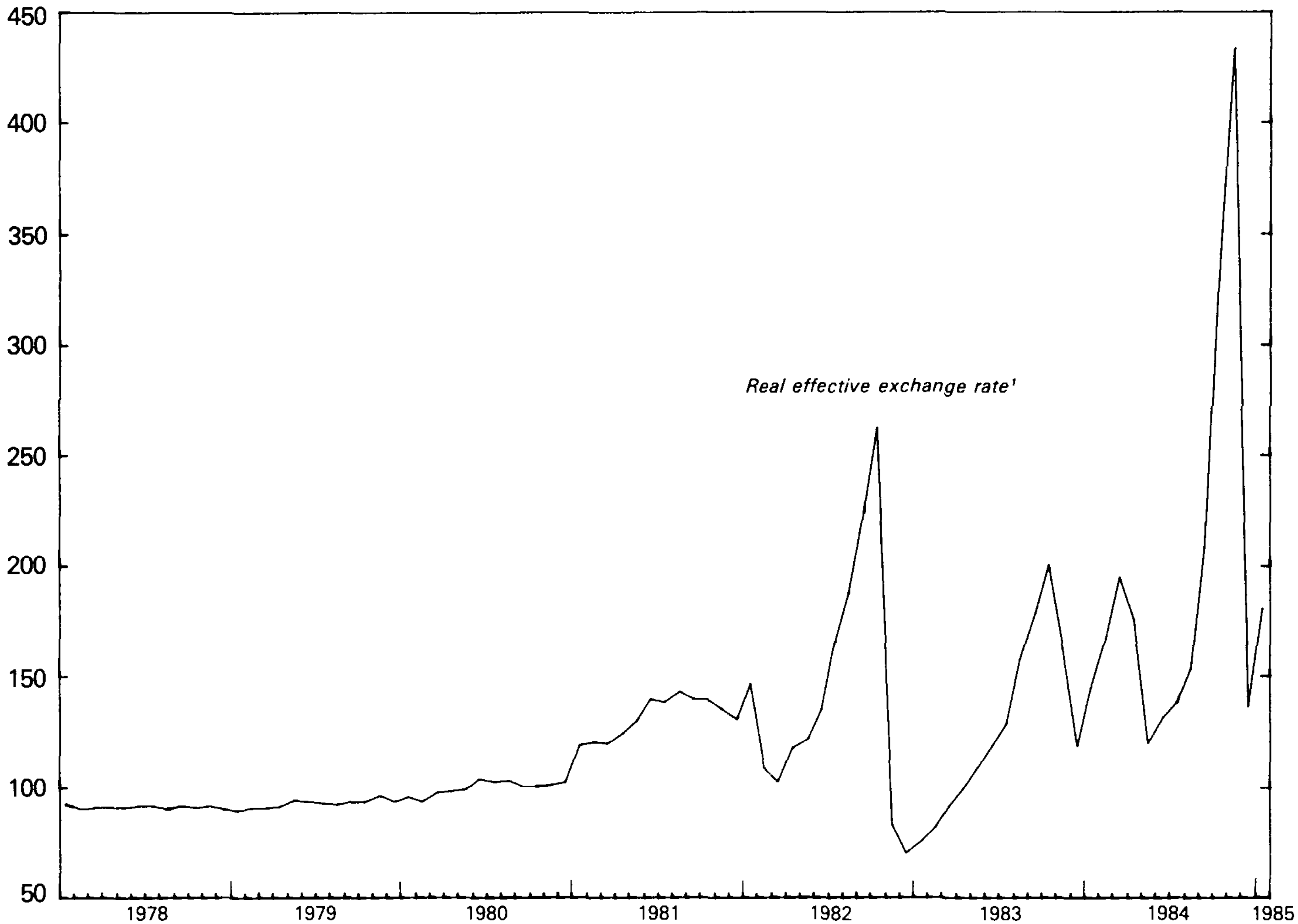
Source: Information Notice System.

1/ Increases mean appreciation.
2/ Using seasonally adjusted price indexes.
3/ Date of latest consideration by Executive Board.
4/ Estimates obtained through extrapolation of the rate of inflation over the six months ending December 1984.

CHART 1

BOLIVIA

INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE



[1] Trade weighted index of nominal exchange rate deflated by seasonally adjusted relative consumer prices, increases mean appreciation.

ATTACHMENT III